FEDERAL ANTITRUST ENFORCEMENT AND SMALL BUSINESS

JOINT HEARING

BEFORE THE

COMMITTEE ON SMALL BUSINESS

AND THE

SUBCOMMITTEE ON STATE, JUSTICE, COMMERCE, THE JUDICIARY, AND RELATED AGENCIES

OF THE

COMMITTEE ON APPROPRIATIONS
UNITED STATES SENATE

NINETY-SEVENTH CONGRESS

SECOND SESSION

ON

FEDERAL ANTITRUST ENFORCEMENT AND SMALL BUSINESS

SEPTEMBER 9, 1982

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HEARING DATE

September 9, 1982:

- Morning Session 1

FEDERAL ANTITRUST ENFORCEMENT AND SMALL BUSINESS

THURSDAY, SEPTEMBER 9, 1982

U.S. SENATE, SMALL BUSINESS COMMITTEE, AND SUBCOMMITTEE ON STATE, JUSTICE, COMMERCE, THE JUDICIARY, AND RELATED AGENCIES, COMMITTEE ON APPROPRIATIONS,

Washington, D.C.

The committee and subcommittee met, pursuant to notice, at 10:05 a.m., in room 424, Russell Senate Office Building, Hon. Lowell Weicker, Jr. (chairman of the Small Business Committee and the subcommittee) presiding.

Present: Senators Weicker, Nunn, Gorton, and Rudman.

Also present: Senator Metzenbaum.

Staff present: Brian F. Hartman, financial analyst, Small Business Committee; Dorothy C. Olson, hearing clerk; Alan L. Chvotkin, minority chief counsel, Small Business Committee; Tom Pulgard, Tom Sadler, and Phil Ward, legislative assistants to Senator Rudman; and Bill Clarke, legislative assistant to Senator Gorton.

STATEMENT OF HON. LOWELL WEICKER, JR., A U.S. SENATOR FROM THE STATE OF CONNECTICUT, AND CHAIRMAN, SENATE SMALL BUSINESS COMMITTEE

The CHAIRMAN. The committee will come to order.

This joint hearing before the Senate Small Business Committee and the Appropriations Subcommittee on State, Justice, Commerce, was called to address a very important issue affecting our small business community, the consumer public, and the national economy: The Nation's antitrust policies and the enforcement of them.

Let me say right off the bat that I am an ardent believer in the antitrust laws and in strong enforcement of those laws. Indeed, I think it also safe to say that about 95 percent of the small business community shares that strong commitment.

It is my view that only through continued, fair, and open competition will our free enterprise system continue to thrive, and the only way to maintain that system of competition is through vigorous adherence to, and enforcement of, the antitrust laws.

Of all the problems that plague our economy today, I believe the most insidious, most pernicious, and, finally, most destructive of them all is the gradual absorption of our small businesses by large corporations and conglomerates. That can be attributed to many things, but one of the primary factors in this growing phenomenon is a lack of enforcement of the antitrust laws of this country.

At the Small Business Committee's last hearing on the issue of antitrust, Mr. Baxter argued that a relaxed merger policy is actually in the interest of small business because, in his words, "small businesses have a strong interest in the existence of a ready market for the sale of their operations."

I would say just the opposite is true. Most small business people I know are not eager to sell. They simply have no choice.

As chairman of the Small Business Committee, I believe small business should be able to look ahead to a future that holds more than just a "ready market for the sale of their operations." Small business owners have a right to a free and open market where they can compete fairly and equally without fear of predatory pricing, dictates from manufacturers, and unfair competition from larger and more powerful firms.

That is why I am so disturbed by the signals the Justice Department's Antitrust Enforcement Division is sending these days. Mr. Baxter in particular, by recent statements, has indicated that in some cases the question of whether to enforce the law or not to enforce it is something that may be left up to his discretion. Now, that is not the way I interpret the law, and I do not think that was the way Congress meant the law to be interpreted when it was enacted.

Mr. Baxter is here today, and I hope that he can go ahead and clear up some of these concerns in his testimony.

Now, because of previous commitments, I am going to have Senator Rudman chair these hearings, but what I would like to do next is to turn to my colleague, the ranking member, Senator Nunn, for any opening statement that he might have.

STATEMENT OF HON. SAM NUNN, A U.S. SENATOR FROM THE STATE OF GEORGIA

Senator NUNN. Thank you very much, Mr. Chairman.

I want to thank you and Senator Rudman for holding these hearings. They are timely, they are important, and I think they will be of considerable interest not only to the small businesses of America but also to the general public.

Last December, the Senate Small Business Committee held hearings, under your direction, on the administration's antitrust policy and its implications for small business. Frankly, during the course of that hearing and even after repeatedly asking questions, I was still at a loss to understand, at least completely understand, the rationale behind some of the statements that Mr. Baxter was making. I believe it is fair to say that small business did not fare too well at that hearing.

During the past several months, the Department has taken additional steps to further enunciate its policies and positions on antitrust matters. In some instances, the Department has used the courts to present its enforcement theories. In some instances, such as with the merger guidelines, the Department has taken formal action to set out its policy and enforcement intentions.

In still other areas, however, the Justice Department's enforcement or lack thereof, as evidenced by the lack of those actions, has been discerned throughout the small business community and throughout the country.

Also, we have had a number of interviews and press accounts that have contributed to understanding, in some cases, to misunderstanding, of the position of the Justice Department under the Reagan administration.

I can certainly understand legitimate disagreements with the underlying rationale for certain antitrust policies. They are many times complicated and complex, and they defy complete understanding. However, in many areas the law is well settled, and the Congress and the American people have a right to know and expect that those officials who hold positions of responsibility in the Government will fully and faithfully execute the laws as they exist.

While the Department of Justice must be given considerable flexibility in its prosecutorial approach to specific factual situations, such discretion does not translate into a wholesale refusal to enforce the statutes which are on the books and which have been clearly interpreted by the courts.

Mr. Chairman, this concern of mine is for more than just the small business community. The concern extends beyond any specific antitrust statute or judicial interpretation. My concern is for the growing perception that the administration is freely giving to the American people that it will utilize the antitrust laws to protect only those who seek a very narrow definition of economic efficiency.

To their credit, the administration has at least been open and blunt about their attitudes in these areas. That gives us a chance to join the issues and discuss them in this hearing and in other appropriate forums.

This hearing and other forums that have been and will be held in the Congress should focus attention on the proper statutory framework of antitrust enforcement. Where there is strong disagreement with the laws as they now exist, the laws, in my view, should be advocated to be changed by the administration, not ignored.

Through the joint efforts of the Senate Small Business, Judiciary, and Appropriations Committees that we have had in the past, I am confident that the small business community will continue to recognize that the vigorous enforcement of our Nation's antitrust laws remains a high priority for us.

In summary, Mr. Chairman, it is my view that where the laws are outmoded, where they are inefficient or ineffective and do not serve the original legislative intent, the administration should come forward and say, Let us change those laws. I do not think they should be ignored or discarded.

Senator RUDMAN. Thank you, Senator Nunn.

STATEMENT OF HON. WARREN B. RUDMAN, A U.S. SENATOR FROM THE STATE OF NEW HAMPSHIRE

Senator RUDMAN. I want to thank Senator Weicker for the opportunity to chair the hearing this morning, a hearing that I want to point out for the record is in some ways a continuation of a hearing of the State, Justice, Commerce, the Judiciary Subcommittee chaired by Senator Weicker on which I also serve that was held on March 2, 1982.

An examination of the record of that hearing would indicate that we invited Mr. Baxter to come back before us to give answers to various questions that were not answered at that time. We consider, then, that this is partially in response to that hearing.

Our Government is one which is founded upon the principle that equality of opportunity ought to be the right of all. That philosophy, spawned by the individuality and competitive nature of those who first settled here, gave rise to an economic engine that became the most powerful in the world.

The foundation of our country is literally identified as the vast strata of small businesses with 500 or fewer employees which produced 87 percent of the 6.8 million new jobs that were created in this country during the period 1965 to 1976.

Further, that base contains small, high technology based firms which are capable of producing up to 24 times more innovations per R&D dollars than larger companies which depend upon them for true innovation. It is well understood today that technology development and transfer, so prevalent in small business, must be stimulated in this country if we are to maintain our preeminence in the world economy.

Unfortunately, the free enterprise system that spawns the base upon which we rely is also capable of devouring itself. Private self-interest leads to consolidation, increased market penetration, and exclusionary competitive practices. None of these are evils in the eyes of entrepreneurs who seek only a competitive edge to secure their own success.

However, society has recognized through its government and courts that competitive practices that operate solely for the benefit of the few may not be justified in view of overall societal needs. The perception of societal needs is not static. Each new administration brings to bear a different philosophical perspective with respect to the ebb and flow of the antitrust debate, which has been continuing for a long time.

Clearly, the present administration, with its suggestion of umbrella contracting for governmental services and its new broader merger guidelines and decreased enforcement of existing antitrust law, offers us a new perspective from which to view problems that have been debated since the early 1900's.

With this general statement, I look forward to hearing the ideas of our witnesses today.

Before I call our first witness, I would like to, without objection, enter into the record a statement by Senator DeConcini.

[The prepared statement of Senator DeConcini follows:]

STATEMENT OF HONORABLE DENNIS DeCONCINI

INTRODUCTION

As a member of Congress who is interested in the plight of small business in our country, I am extremely concerned about the direction of the Antitrust Division's enforcement policy. Recently I wrote to Mr. Baxter, the Assistant Attorney General in charge of the Antitrust Division, and asked him for a full explanation of a report carried in the Washington Post regarding the Division's policy regarding resale price maintenance.

In response to my inquiry I received a vague response saying that the Division's limited resources would be employed in "those cases which will yield the greatest gains for consumers." Furthermore, the Assistant Attorney General's letter implies that resale price maintenance is one practice which may be of some benefit to consumers.

I believe that the Assistant Attorney General's position, that the Federal courts present approach to resale price maintenance is incorrect, is improper on three distinct grounds.

First, it is based on unproven economic assumptions.

Second, it repudiates the current interpretation of the Sherman Act which has remained constant in the Federal courts for the last 70 years. (This has been one of the few areas of antitrust law in which there had been a great deal of certainty.) Mr. Baxter has placed himself above the courts and the Congress placing this area of the law in flux and thereby creating needless confusion in the marketplace.

Third, and perhaps most importantly, Mr. Baxter's policy of non-enforcement and his expressed intention to change the law ignores a clear representation of Congressional approval of the state of the law as it is. The Supreme Court has explicitly and correctly recognized that the repeal of the Miller-Tydings and Mcguire Acts is a clear expression of Congressional approval of the current per se rule against resale price maintenance.

Assistant Attorney General Baxter's Economic Assumptions are Unproven and Unrealistic

The Antitrust Division's enforcement policy is one of non-enforcement. The Division assumes that a perfectly competitive market will cure the evils of many practices, including resale price maintenance, which were previously vigorously attacked under our antitrust laws. Mr. Baxter explicitly assumes that vertical price agreements between manufacturers and distributors "are typically conducive to competition and economic efficiency." This statement, which repudiates seventy years of Federal court interpretation of the Sherman Act, is only qualified by the assumption that the manufacturers and distributors involved are acting in a perfectly competitive market.

Neither of these assumptions reflect the reality of the marketplace. Moreover, they are symptomatic of a far greater problem which has come to dominate the minds of those responsible for the enforcement of our laws.

This is their dogmatic and almost religious belief that the only considerations which should be taken into account in framing an antitrust policy are economic. Traditional political and social considerations which were at the forefront when Congress enacted the antitrust laws are no longer seen to be relevant.

Baxter's Approach to Resale Price Maintenance Has Repudiated Seventy Years of Federal Court Decisions and Injected Confusion Into The Marketplace

Beginning with the Dr. Miles case in 1911, the Supreme Court has consistently held that resale price maintenance violates the Sherman Act. Later cases have made it clear that "RPM" is illegal not only when the restraint involved is unreasonable but because of its dangerous nature, (RPM is almost certain to raise prices to consumers whenever it is employed) the courts have found it to be illegal "per se".

The effect of this repudiation is to place distributors at the mercy of manufacturers who wish to employ RPM as a means of implementing horizontal price fixing schemes. If the distributors threaten to bring a private action under Section Four, the manufacturers simply counter with a threat to cut off their supply of goods. Without help from the Justice Department these distributors, especially if they are small businesses, are caught between a rock and a hard place. Either they can implement the RPM scheme required by the manufacturer, which results in raising their prices to the ultimate consumer and lowering their volume of sales, or they can refuse to implement the RPM and lose their supplier.

Baxter Has Ignored a Clear Expression of Congressional Intent Regarding the State of the Law On Resale Price Maintenance

In 1975 Congress enacted the Consumer Goods Pricing Act, P.L. 94-145 (1975). This act had the effect of repealing the last "Fair Trade" law which was still on the books. The Consumer Goods Pricing Act was specifically enacted so that competition could play a more expanded role in distribution. By passing this law Congress placed a stamp of approval on the interpretation of the Sherman Act that had been developed over the course of better than sixty years by the Federal courts and particularly the Supreme Court.

The Supreme Court recognized that this act of Congress had such an effect in a major antitrust opinion handed down in 1977. To limit the court's holding in the GTE Sylvania case Justice Powell wrote a footnote which says:

> The per se illegality of price restrictions has been established firmly for many years....Furthermore, Congress recently has expressed its approval of a per se analysis of vertical price restraints by repealing those provisions of the Miller-Tydings and McGuire Acts allowing fair trade pricing at the option of the individual states. (Continental T.V., Inc. v. GTE Sylvania, Inc. 433 U.S. 36, 51n. 18(1977).

For Mr. Baxter to refuse to enforce this clear expression of Congressional intent, indeed for the Antitrust Division to advocate attempts through private litigation to change the law, goes beyond a mere derelection of duty. The executive branch of our government was created to carry out the will of the people as expressed by their elected representatives in Congress. For Mr. Baxter to refuse this duty flies in the face of our Constitutional system of government. To allow this type of behavior to persist would be to allow our government to become one of men and not laws.

Mr. Baxter's role within our scheme of government is to apply the laws which Congress enacts. The fact that he may or may not agree with those laws should not have any bearing on his official conduct. He is always free to urge the Administration to petition Congress for changes. If Mr. Baxter cannot for personal reasons apply the law, he should resign his position.

Senator RUDMAN. Our first witness today will be our colleague, Senator Howard Metzenbaum of Ohio. Senator Metzenbaum?

STATEMENT OF HON. HOWARD M. METZENBAUM, A U.S. SENATOR FROM THE STATE OF OHIO

Senator METZENBAUM. Mr. Chairman and members of the committee, first let me commend the chairman, Senator Weicker, and Senator Rudman for conducting these hearings and for the leadership that you have given in connection with the whole area of small business and small business involvement in the free enterprise system.

Senator Nunn, I commend you well for your obvious knowledge and comprehension of the issues concerning that which to some is a very technical kind of subject. I know you are all distinguished lawyers. I know, Senator Rudman, of your efforts as the Attorney General of New Hampshire and the distinguished record you had in that respect as far as antitrust law enforcement is concerned.

I appreciate the opportunity to appear before this committee. As you well know, there no longer is an Antitrust Subcommittee of the Senate. I formerly chaired that committee, and I feel that antitrust is actually the basis of the free competitive forces working and working well in the free enterprise system to make it achieve its highest and best objectives.

Four months ago, as a matter of fact, President Reagan said that small business is the heart and soul of free enterprise. But over the last 2 years, I have grown increasingly alarmed at the failure of the President's own hand-picked antitrust officer to protect small business from predatory competition. It has been an indifference, a callous disregard for the law, that caused me to today call for the resignation of William F. Baxter, Assistant Attorney General for Antitrust.

I do not make that statement lightly. I firmly believe it would be the right thing to do because, as one of the Nation's top law enforcement officers, his duty is to execute and enforce the law. But, ever since his confirmation hearing, Mr. Baxter has pursued his own antitrust agenda. That agenda is not only wholly at odds with the law as written by Congress and interpreted by the Supreme Court, but it also subverts. the public's right to a smoothly functioning free enterprise system with competitive forces working.

We have a chief antitrust officer who calls Supreme Court decisions on competition "rubbish" and "idiocy." He has repeatedly said he will disregard these decisions and follow his own personal opinions in enforcing antitrust laws.

Further, Mr. Baxter has ignored the specific intent of Congress on antitrust matters and instead adopted policies reflecting his own peculiar economic theories.

This blatant flouting of the Supreme Court and Congress provides more than ample grounds to ask for Mr. Baxter's resignation. But there is more. Mr. Baxter has deliberately withheld information from Congress, the Attorney General, and the President revealing a possible conflict of interest in his handling of the IBM antitrust litigation.

Now, frankly, as a private citizen, Mr. Baxter is free to criticize Congress and the courts as often and as harshly as he wants. But as a public official, he is bound to enforce the law, however much he personally disagrees with it.

If he finds the laws and the court decisions too odious to enforce, he may seek changes through established constitutional channels, or he may resign. As Senator Nunn has so aptly put it, if he doesn't agree with the laws, he certainly is free to come to the Congress and urge the Congress to change the law. But that is not what Mr. Baxter has done.

I believe that Mr. Baxter's refusal to adhere to the laws and court decisions and his further effort to rewrite and reinterpret both in clear violation of the separation of powers doctrine compel his resignation.

Let me review some of Mr. Baxter's statements and activities: His most serious shortcomings involve his failure to enforce laws barring certain forms of "vertical" restraint. Now, a vertical restraint is an agreement between parties on different points of the distribution chain. For example, an agreement between a manufacturer and a retailer to fix prices would be illegal vertical price fixing. This sort of price fixing is particularly harmful to consumers because it can be used to prevent wholesalers or retailers from offering discount prices.

In 1980 the Federal Trade Commission and several dozen States settled vertical price fixing cases against Levi Strauss. What happened? Soon thereafter, the price of Levi's jeans dropped tremendously.

The Supreme Court has repeatedly stated that vertical price fixing is illegal; most recently in the 1980 *Midcal* case. But Mr. Baxter was unimpressed. On February 25, 1982, he told the House Judiciary Committee that the practices condemned by the Supreme Court are "not only lacking in anticompetitive effect but may in fact enhance efficiency * * * the Antitrust division has already incorporated these views in its enforcement approach in the vertical area."

In other words, the Justice Department is following the law according to Baxter, not the law according to Congress and the highest court in our land.

Similarly, the Supreme Court has held that price fixing among competitors is illegal regardless of the price level agreed upon. It has said that such "maximum price fixing" is totally inconsistent with the free enterprise system.

In June 1982, the Supreme Court said in the *Maricopa* decision that, "We have not wavered in our enforcement of the per se rule against price fixing." The court has further ruled that agreements to stabilize prices within a certain range are also illegal.

But what has Mr. Baxter said? In a February 22, 1982, memo to all antitrust division attorneys, he declared that the notion that price "stabilization" agreements are automatically illegal is "idiocy of an even higher order than the suggestion that agreements lowering prices" are illegal. He added that the original court statement on the subject was an "outrageous generalization."

Now, confronted with the *Maricopa* decision reaffirming the illegality of maximum price fixing and price stabilization, Mr. Baxter still belittled the High Court's language, saying on July 21, 1982, that it is "still an outrageous generalization"; whereupon, he ordered Justice Department attorneys to "excise the word 'stabilization' from their official usage."

A third area where Mr. Baxter has substituted his view of the law for that of Congress and the courts involves certain types of mergers. In 1950, Congress expanded the antimerger laws and in so doing outlawed certain mergers not only between competing companies but also between companies that may not be direct competitors. These vertical mergers should be distinguished from other vertical restraints, such as the vertical pricefixing I described a few moments ago.

One landmark vertical merger involved a shoe manufacturer's attempted purchase of a chain of retail shoe stores. The Supreme Court said the acquisition was illegal.

A second example was Ford Motor Co.'s purchase of Autolite spark plugs. The Supreme Court here also blocked the acquisition in 1972 because it would have lessened competition in the spark plug industry and reduced the possibility that Ford's competitors could buy Autolite spark plugs.

Enter Mr. Baxter to undo two decades of firmly established antitrust law. He declared the court rulings in the Ford case and the shoe case as "wacko" and "rubbish."

Mr. Baxter told the House Judiciary Committee on April 29, 1981, that doctrines and court rulings attacking vertical mergers "are almost totally incoherent * * * there is no such thing as a harmful vertical practice. There is no such thing as a vertical problem."

There are several other examples of Mr. Baxter's disdain of Congress and the courts, and there is also disturbing evidence regarding his personal integrity and fitness for office.

On January 8, 1982, Mr. Baxter dismissed the Government's 13-year-old antitrust suit against IBM. Soon thereafter, we learned that Mr. Baxter had several business relationships with IBM prior to joining the Government. The trouble is, Mr. Baxter didn't bother to tell the judge handling the IBM case, the Congress, or those who interviewed him about his new position. They were, he said grandly, too trivial to report.

In one case, he was paid $1,500 by IBM attorneys to locate an expert economic witness to testify in the Government's case against the computer giant. Some years earlier, he negotiated what he described as an arrangement under which IBM paid him his entire annual salary to prepare a memo suggesting how the company could sell more computer equipment to the legal profession.

Now, it is incredible that Mr. Baxter made this last disclosure about being paid for an entire year by IBM only in a deposition on February 25, 1981. When? Just 1 month before the Senate hearings on his confirmation. Somehow he managed to remember it during the deposition, but somehow he forgot it when I asked him to provide the dates, nature, and compensation of all his consulting relationships.

Mr. Chairman, a year ago, President Reagan eloquently stated that our forefathers' "insistence on the free enterprise system unleased the creative energies of a people, built the foundation of our unparalleled political and economic freedom, and brought forth a vital force in the world."

Unfortunately, the President's own chief officer responsible for policing the free enterprise system has abdicated his responsibility to uphold the law. His policies are threatening the livelihood of thousands of small businesses and draining the pocketbooks of millions of Americans.

For the sake of our economy, for the sake of small business, and for the sake of American consumers, I very strongly feel that the only decent thing, the only right thing for Mr. Baxter to do would be to resign his position.

I thank you.

[The prepared statement of Senator Metzenbaum follows:]

STATEMENT OF SENATOR HOWARD M. METZENBAUM

Mr. Chairman, I appreciate the opportunity to testify before your oversight hearings on antitrust enforcement as it affects small business.

Four months ago, President Reagan said that, "Small business is the heart and soul of free enterprise." But over the last two years, I have grown increasingly alarmed at the failure of the President's own hand-picked antitrust officer to protect small business from predatory competition. Accordingly, I am calling today for the resignation of William F. Baxter, Assistant Attorney General for Antitrust.

As one of the nation's top law enforcement officers, his duty is to execute and enforce the law. But ever since his confirmation hearing. Mr. Baxter has pursued his own antitrust agenda. That agenda is not only wholly at odds with the laws as written by Congress and interpreted by the Supreme Court, but it also subverts the public's right to a smoothly functioning free enterprise system.

We have a chief antitrust officer who calls Supreme Court decisions on competition "rubbish" and "idiocy." He has repeatedly said he will disregard these decisions and follow his own personal opinions in enforcing antitrust laws.

Further, Mr. Baxter has ignored the specific intent of Congress on antitrust matters and instead adopted policies reflecting his own peculiar economic theories.

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As a private citizen, of course, Mr. Baxter is free to criticize Congress and the courts as often and as harshly as he wants. But as a public official, he is bound to enforce the law, however much he personally disagrees with it.

If he finds the laws and the court decisions too odious to enforce he may seek changes through established constitutional channels or he may resign. I believe Mr. Baxter's refusal to adhere to the laws and court decisions, and his further effort to rewrite and reinterpret both in clear violation of the separation of powers doctrine, compel his resignation.

Let me review some of Mr. Baxter's statements and activities:

His most serious shortcoming involves his failure to enforce laws barring certain forms of "vertical" restraint. A vertical restraint is an agreement between parties on different points of the distribution chain. For example, an agreement between a manufacturer and a retailer to fix prices would be illegal "vertical" price fixing. This sort of price fixing is particularly harmful to consumers because it can be used to prevent wholesalers or retailers from offering discount prices. In 1980, the Federal Trade Commission and several dozen states settled vertical price fixing cases against Levi Strauss. Soon thereafter, the price of Levi's jeans dropped tremendously.

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But what has Mr. Baxter said? In a February 22, 1982, memo to all antitrust division attorneys he declared that the notion that price 'stabilization' agreements are automatically illegal is "idiocy of an even higher order than the suggestion that agreements lowering prices" are illegal, adding that the original court statement on the subject was an "outrageous generalization."

Confronted with the *Maricopa* decision reaffirming the illegality of maximum price fixing and price stabilization, Mr. Baxter still belittled the high court's language, saying on July 21, 1982, that it is "still an outrageous generalization." Whereupon, he ordered Justice Department attorneys to "excise the word 'stabilization' from their official useage."

A third area where Mr. Baxter has substituted his view of the law for that of Congress and the courts involves certain types of mergers. In 1950, Congress expanded the anti-merger laws and in so doing outlawed certain mergers not only between competing companies, but also between companies that may not be direct competitors. These "vertical mergers" should be distinguished from other vertical restraints, such as the vertical price-fixing I described a few moments ago. One landmark "vertical merger" involved a shoe manufacturer's attempted purchase of a chain of retail shoe stores. The Supreme Court said the acquisition was illegal. A second example was Ford Motor Co.'s purchase of Autolite Spark Plugs. The Supreme Court blocked the acquisition in 1972 because it would have lessened competition in the spark plug industry and reduced the possibility that Ford's competitors could buy Autolite Spark Plugs.

Enter Mr. Baxter to undo two decades of firmly established antitrust law. He declared the court rulings in the *Ford* case and the *Shoe* case "wacko" and "rubbish."

Mr. Baxter told the House Judiciary Committee on April 29, 1981, that doctrines and court rulings attacking vertical mergers "are almost totally incoherent . . . there is no such thing as a harmful vertical practice. There is no such thing as a vertical problem."

There are several other examples of Mr. Baxter's disdain of Congress and the courts. And there is also disturbing evidence regarding his personal integrity and fitness for office.

On January 8, 1982, Mr. Baxter dismissed the government's 13 year-old antitrust suit against the IBM Corporation. Soon thereafter, we learned that Mr. Baxter had several business relationships with IBM prior to joining the government. The trouble is, Mr. Baxter didn't bother to tell the judge handling the IBM case, the Congress or his prospective superiors about these relationships. They were, he said grandly, too "trivial" to report.

In one case, he was paid $1,500 by IBM attorneys to locate an expert economic witness to testify in the government's case against the computer giant. Some years earlier, he negotiated what he described as "an arrangement" under which IBM paid him his entire annual salary to prepare a memo suggesting how the company could sell more computer equipment to the legal profession.

Incredibly, Mr. Baxter made this last disclosure in a deposition on Feb. 25, 1981—just one month before the Senate hearing on his confirmation. He managed to remember it during the deposition but somehow forgot it when I asked him to provide the dates, nature and compensation of all his consulting relationships.

A year ago, President Reagan eloquently stated that our forefathers' "insistence on the free enterprise system unleashed the creative energies of a people, built the foundation of our unparalleled political and economic freedom and brought forth a vital force in the world."

Unfortunately, his own chief officer responsible for policing the free enterprise system has abdicated his responsibility to uphold the law. His policies are threatening the livelihood of thousands of small businesses and draining the pocketbooks of millions of Americans. For the sake of our economy, for the sake of small business and for the sake of American consumers, Mr. Baxter must go.

Senator RUDMAN. Thank you very much, Senator Metzenbaum. I do not have any questions at this time. Senator Nunn?

Senator NUNN. Just a couple, Senator Metzenbaum.

Are you aware of any significant changes the Justice Department or Mr. Baxter have proposed to the existing law in the form of testimony before the Judiciary Committee of the House and Senate?

Senator METZENBAUM. I am not. He has testified on existing bills but has made no proposals on the Justice Department itself.

Senator NUNN. But there are no pending proposals advocating change in the existing law that you know of, or at least significant proposals?

Senator METZENBAUM. None that have been submitted or proposed by the Justice Department.

Senator NUNN. Are you aware of any friend-of-the-court briefs asking the Supreme Court to reverse its position on specific antitrust law interpretations that have been filed by this administration or the Justice Department?

Senator METZENBAUM. We are not aware of any that have been filed as of this date.

Senator NUNN. What we have, in your opinion, I assume, is statements which indicate the lack of will to enforce the law and total disagreement with the law by Mr. Baxter. Yet, we do not have, to the best of your knowledge, any kind of advocacy by the administration or by the Justice Department to actually change the law through the legislative process or through court decisions.

Senator METZENBAUM. As is so often the case, the Senator from Georgia is right on target. There would certainly be nothing wrong with Mr. Baxter coming in and advocating changes in the law to the Congress or filing a brief, an amicus brief, with the Court or even intervening in a case advocating a reversal of a Supreme Court decision.

He has not done that. He has directed his staff either to disregard the law or has made it quite clear that he personally will see to it that the Department disregards the law.

Senator **Nunn**. Do you assume that Mr. Baxter's views are the official Justice Department position, or do you see room for divergence between his own views as expressed and the Justice Department official position? What do you assume on that point?

Senator **Metzenbaum**. I assume that he is speaking the official position of the Justice Department because his views have been publicly proclaimed; his views have received the attention of the media; and there has been no indication from the Attorney General or anyone else in the Department, or anyone else in the administration, indicating disagreement with Mr. Baxter's publicly expressed views.

Senator **Nunn**. Has the Attorney General himself testified on antitrust matters before the Congress, to your knowledge?

Senator **Metzenbaum**. Not to my recollection, Senator.

Senator **Nunn**. Thank you very much, Senator.

Senator **Metzenbaum**. I thank you.

Senator **Rudman**. Thank you, Senator Metzenbaum.

Senator **Metzenbaum**. I appreciate the courtesy.

Senator **Rudman**. Our next witness will be William F. Baxter, Assistant Attorney General, Antitrust Division.

Mr. Baxter, we are pleased to welcome you to this hearing.

I have your statement here. It is rather lengthy. It certainly will be incorporated in the record, with all of its attachments, and of course we would like you to take whatever time you would like to summarize that. I expect you do not want to read it verbatim.

However, in light of some of the statements by the opening witness, if you wish to at any point here proceed to any of those, you may, or if you prefer to supply us with a written response to be part of the record, we will keep the record open for this hearing, whatever your wish.

STATEMENT OF WILLIAM F. BAXTER, ASSISTANT ATTORNEY GENERAL, ANTITRUST DIVISION, DEPARTMENT OF JUSTICE

Mr. **Baxter**. Thank you very much, Senator Rudman.

I welcome the opportunity to be here this morning to respond to the topics which I was told would be the subject matter of this morning's hearings and to some of the fairly outrageous statements that have been made on other topics.

The concern, of course, of the Antitrust Division is to maintain a free and open economy in which business enterprises of all sorts have equality of opportunity and, through their interactions, yield goods and services in the greatest possible abundance from such limited resources as are always available to any economy.

The central threat to the fullest possible utilization of our resources with which the Antitrust Division is concerned is cartelization, and the central prohibitions of the antitrust laws, of course, are directed against cartelization.

The key feature—indeed, the proper test of whether an arrangement between business enterprises can be regarded as one involving cartelization—is whether it restricts output. The agreements that tend to restrict output, more or less of necessity, have the consequence of causing price increases, and price increases thus induced are harmful to an economy.

An important form of activity that bears on the problem of cartelization indirectly is that of mergers. Your invitation to me to appear this morning indicated that the topic which you wished to have primarily addressed was that of the Department's new merger guidelines.

Merger activity in general is a very healthy phenomenon of capital markets. It is a mechanism by which resources are transferred from hands in which they find themselves to hands which indicate, through the market, that they believe themselves able to use them more productively by bidding more for them than the value ascribed to them by those who presently hold them. Of course, that process is prerequisite to any transfer of resources.

The existence of a free market in capital, a free market indeed in companies and portions of companies, is particularly important to the small business community with which I know you are concerned. There are a very, very large number of instances in which small businesses find the opportunity of entering into mergers of various kinds important to their health; they reduce the risks which they confront and, by doing so, stimulate the formation of small business in the first instance.

Some examples of such instances are situations in which the founders of a business, having brought it to some fairly high level of success, are anxious to retire, and yet their estate consists very largely of a business which may be in the form of a proprietorship or in the form of a closely held corporation whose shares are not publicly traded, and therefore estate tax problems of very substantial magnitude may be encountered upon the founder's death. It is frequently the desire of successful small businessmen in that position to convert the holdings of their estate into publicly traded shares to eliminate that kind of problem, and very frequently under circumstances such as these they will seek an acquisition partner in a stock-for-stock trade. This is an important form of cashing in for a small business at the end of a successful business career.

Perhaps even more important in terms of the performance of the economy decade after decade is a generational life cycle phenomenon of individual businesses that exists and is not, I think, well understood. It is popularly said that small businesses are highly innovative. That statement in a sense is true, but the sense in which it is true is not, I think, the sense in which it is usually understood.

If one simply created a small business and waited for it to be innovative, one might wait a long while indeed. People who have highly innovative ideas, wherever they may be in the economy—and frequently they are fairly senior employees of very large corporations—when they have a new idea which they think is susceptible to commercialization, will usually choose to form a new, small enterprise as a vehicle for the exploration and exploitation of that innovation. Thus, for example, several of our most successful computer companies were formed by high ranking IBM employees who had ideas about new computer products and who left IBM to form new small businesses and to exploit their ideas in those new businesses.

Consequently, we have the constant emergence and formation of small, highly innovative enterprises, and I think it is fairly clear that a very large fraction of innovation and early product development does occur in relatively small enterprises.

It is equally clear that larger enterprises are quite characteristically more efficient manufacturers and distributors. Thus, when product development has reached an advanced stage and as the demand for the product expands, it often will be in the interest of the small business enterprise to merge with some larger enterprise and take advantage of the larger enterprises manufacturing experience and its established distribution networks. This is another example in which acquisitions are important to the continuing success and financial rewards and, therefore, to the rate of creation of small business enterprises.

Of course, those are not the only highly desirable and important consequences of mergers; simply the transfer of assets between larger business enterprises in response, for example, to shifting resource values or to sharply changing factor inputs, makes redistribution of assets economically desirable and economically profitable. Economic desirability and economic profitability of course, except under unusual circumstances, go very closely together.

There was a period of time, when the interpretation of the antitrust laws was extremely permissive toward corporate acquisitions and mergers of various kinds. Troubled by that situation, the Congress in 1950 passed the Celler-Kefauver Act which suggested that more attention should be paid by the courts in the future as to whether corporate acquisitions may substantially lessen competition in any line of commerce.

Furthermore, passage of the Celler-Kefauver Act indicated congressional awareness that a substantial lessening of competition in a line of commerce could be brought about by acquisitions between corporations which were not presently direct horizontal competitors. Prior to the Celler-Kefauver Act, section 7 of the Clayton Act had been limited to acquisitions that eliminated competition between the acquiring and the acquired company, and that phrase was quite wisely abandoned by the 1950 act.

There followed, however, in the late fifties and early sixties a period of extremely restricted interpretations of the language of the amended section F by the courts. Mergers were struck down on a variety of grounds and under circumstances in which no one could plausibly have supposed that competition in any meaningful sense of the phrase had been substantially lessened in any line of commerce.

One of the devices that was used to accomplish this result was to define artificially narrow markets that did not correspond in any economic sense to a line of commerce and then find that concentration was extremely high within the market as so artificially defined. Thus, the threat of a substantial lessening of competition as a result of a merger within that market appeared quite high. This approach became a widely-remarked-upon phenomenon, and there was a great deal of writing and criticism of those cases.

In the late sixties and into the early seventies, the courts quite rightly began backing away from those decisions, and a much more sensible pattern of decisionmaking in the merger area appeared.

However, it was the case in 1968, before this reversal in the pattern of cases became evident, that the Antitrust Division issued a set of merger guidelines which were themselves quite inconsistent in some respects with some of the more extreme cases that had been decided. For example, the 1968 merger guidelines themselves made very clear that the *Brown Shoe* decision of 1962, of which Senator Metzenbaum spoke, I believe, a few moments ago, would not have been attacked under those guidelines.

Although the 1968 guidelines were less extreme than the cases of the time period, they nevertheless were very extreme. In the years that followed, both the cases as decided by the Federal courts, including the Supreme Court, and the Antitrust Division's own enforcement practices shifted further and further away from the 1968 guidelines. By the time I arrived at the Antitrust Division, there was almost no correspondence between the Division's current merger enforcement practices or the courts' decisions in merger cases that were then being decided by the Federal courts and the 1968 guidelines.

For those reasons, I announced, practically on the day of my arrival, that one of my major objectives was to accomplish during the time I held this position, a rewriting of the merger guidelines along lines that were consistent with the present state of knowledge about what kinds of mergers are, in fact, beneficial and what kinds are, in fact, harmful.

I will not try to summarize the merger guidelines in any particular respect, although I would be delighted to answer questions about any aspect of them.

Senator RUDMAN. We have them in the record in your statement, and we think probably it would be best to summarize them.

Mr. BAXTER. Well, I think I will not even try to summarize them this morning, Senator.

Senator RUDMAN. All right.

Mr. BAXTER. As I say, I would be happy to do so in writing if you so request.

Senator RUDMAN. I don't request a summary. We do have it.

Mr. BAXTER. Sure. The only point I wish to make now is that the new guidelines address not only horizontal mergers, but nonhorizontal mergers as well. They do not refer to nonhorizontal mergers as vertical mergers, it is quite true; but it is totally false, as suggested earlier this morning, that they give blanket blessing to any vertical merger. That suggestion simply is not accurate. The guidelines explain at some length the circumstances under which a vertical merger may be harmful and indicate that the Antitrust Division will attack nonhorizontal mergers, including vertical mergers, where those conditions are satisfied.

Well, I think I will desist with my comments on the merger guidelines at this particular point.

I would, however, like to comment on the other topics that were mentioned this morning. There is a great irony about some of the criticism that has been raised. An enormous procession of Assistant Attorneys General has proceeded me to this office. In almost every instance, those persons have been dissatisfied with one aspect or another of the antitrust laws. Many of them advocated more and more extreme and, in my view, economically baseless extensions of antitrust law to a wide variety of activities which had never theretofore been brought within the antitrust laws.

Peculiarly, the voices that are raised in criticism now thought those prior activities were absolutely laudable, marvelous, courageous, imaginative, or a variety of other things. Those activities were not said to be lawless, and I recall no resignations having been called for when it was suggested that reciprocity was an outrageous evil that must be stamped out, or when various totally specious theories of antitrust liability were advanced in the courts.

But the slightest step in the other direction has been greeted with absolute horror. I suggest there is a certain irony about all that. One cannot have it both ways. One could come to my job with a rather passive, inactive, law enforcement attitude that the job has nothing to do with the formation of rational antitrust policy, and that it simply requires a reading of the most recent Supreme Court cases and bringing those enforcement actions which happen to correspond to them without any thought as to whether one is improving or damaging the performance of the economy.

I could understand such an attitude toward the responsibilities of the office, although I do not share it. I share, rather, the attitude of most of my predecessors that the job is, in significant part, one of policymaking, one of education, one of urging upon the courts what industrial organization economists have learned in recent years, and we have done that. We have filed numerous briefs in many courts about which Senator Nunn asked, urging the courts to change their views.

I make no apologies for any of that. I intend to go right on doing it, and I think it is precisely what is called for by the responsibilities of the job. If the President or the Attorney General is unhappy with that at any point, I am sure they will let me know, and I will help them find a replacement.

That completes my initial comments, Senator Rudman. Thank you very much.

[The prepared statement of Mr. Baxter follows:]

U.S. Department of Justice

Washington, D.C. 20530

STATEMENT OF

WILLIAM F. BAXTER
ASSISTANT ATTORNEY GENERAL
ANTITRUST DIVISION

BEFORE THE

COMMITTEE ON SMALL BUSINESS

AND

SUBCOMMITTEE ON STATE, JUSTICE, COMMERCE,
THE JUDICIARY, AND RELATED AGENCIES
COMMITTEE ON APPROPRIATIONS

UNITED STATES SENATE

CONCERNING

THE JUSTICE DEPARTMENT'S MERGER GUIDELINES
AND ANTITRUST POLICIES

SEPTEMBER 9, 1982

Mr. Chairman, members of the Committee and Subcommittee:

I am pleased to be here this morning to discuss with you the Justice Department's revised Merger Guidelines and other antitrust enforcement policies, and how these policies affect the small business community.

The central function of antitrust enforcement is protecting the competitive vitality of our economy, a goal that not only benefits consumers, but also makes it possible for enterprising and efficient small businesses to thrive. The Justice Department is firmly committed to vigorous enforcement of the antitrust laws to combat activities that threaten competition, while avoiding unnecessary interference with the ability of businesses to maximize their productivity and efficiency.

As I have repeatedly stated, the clearest example of behavior that restricts competition is cartel activity such as minimum price fixing, market allocation, bid rigging, supply restrictions, or comparable agreements among competitors. Such activity will continue to be the primary focus of our enforcement efforts, and we will continue to seek indictments of individuals whenever possible and to recommend jail sentences and substantial fines as a matter of course.

I would like now to turn to our recently issued Merger Guidelines and our merger enforcement policy, which I understand are the principal focus of this hearing. As I am sure you are well aware, the relevant inquiry under the antitrust laws is whether the particular merger or acquisition under consideration threatens significantly to lessen competition in a particular product and geographic market. The critical factor in this determination is whether the proposed transaction creates a significant potential for adverse horizontal effects in any realistically-defined market.

Challenging mergers that have the potential for such anticompetitive effects remains an important part of our enforcement program. It is equally important, however, not to interfere with proposed acquisitions that may be competitively neutral or procompetitive. Unfortunately, there has been some confusion in the law in this area. In prior testimony, I have explained the source of this confusion and how the law has been changing for the better in recent times. */ Rather than repeat that testimony, suffice it to say that, in the last seven or eight years, courts have begun gradually to broaden their analysis beyond historical market share data to include a more realistic assessment of the likely competitive effects of proposed transactions.

Although our merger enforcement policies have generally followed the evolution of the law in this area, the Department's 1968 Merger Guidelines were never previously modified to reflect this evolution. As a result, they became an inaccurate summary of current law, economic understanding, and the Department's actual enforcement practices. To rectify this situation, on June 17, 1982, we issued new Merger Guidelines, which incorporate current legal and economic thinking in the merger area. We believe that these Guidelines will help define appropriate relevant markets and assess the anticompetitive risks in those markets associated with mergers. In this way, the Guidelines will help to deter anticompetitive mergers and, at the same time, avoid interference with procompetitive or competitively neutral transactions.

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*/ Statement of William F. Baxter before the Committee on Small Business, Subcommittee on Productivity & Competition concerning Antitrust Aspects of Small Business, December 1, 1981.

As I indicated to Chairman Weicker when I provided him with an advance copy of the Guidelines prior to their official release, the Guidelines are tightly constructed and contain numerous cross-references and, hence, may require some time for study. We have supplied the members with copies of the Guidelines, and rather than attempt to summarize or abstract them, I would prefer to let them speak for themselves.

The enforcement policy reflected in the Guidelines will be of particular benefit not only to consumers and society generally, but also to the health and well-being of small business. For example, small businesses have a strong interest in the existence of a ready market for the sale of their operations. This can be an important incentive to investment for small entrepreneurs since it enables them to recover their investments of time and money should they choose to retire or sell their businesses. Moreover, there comes a point in the life of many successful small businesses when the individuals responsible for their success can best reap the true value of their efforts by merger with another firm able to offer significant production or other advantages. Moreover, a ready market for non-anticompetitive sales of small enterprises also benefits such firms by reducing the risks of business setback, allowing a floundering business to be revived through merger with another firm that can provide a needed transfusion of finances, new management, or new ideas. In addition, a precise examination of the likely competitive effects of mergers, designed not to interfere with transactions posing no real threat to competition, protects small businesses for whom merger may become an important option for legitimate tax reasons; for example, achieving some degree of capital liquidity in the estates of the developers and innovators who brought them into existence.

I would like to turn now to other areas in which our enforcement policies aid small businesses while maximizing consumer welfare. Like merger policy, enforcement policy in the area of vertical arrangements has been the subject of considerable rethinking and analytical refinement over the last two decades. It is clear that vertical distributional arrangements such as assigned territories or resale price maintenance may, under some circumstances, be used to facilitate collusion and thus adversely affect horizontal competition. However, lawyers, economists, and the courts increasingly have come to recognize that in most instances such anticompetitive effects are not always--or even generally--likely to result. Indeed, current economic analysis demonstrates that an individual firm's choice as to distributional arrangements, such as the granting of franchises or the grouping of goods and services for sale, may simply reflect a firm's judgment about the most efficient and effective way to structure its marketing efforts. Manufacturers, dealers, and consumers may benefit from the resulting strengthening of competition.

Thus, our enforcement actions against vertical restraints have been rare in recent years, under past Administrations as well as the present one, as we have found very few instances in which such restraints threatened genuine harm to the interests protected by the antitrust laws. Our approach in this area not only benefits consumers, but also benefits small businesses. It is often new small manufacturing enterprises that can benefit particularly from vertical arrangements designed to induce competent and aggressive dealers to spend the time and money necessary to develop a retail market for the manufacturer's new product. Moreover, retail dealers, many of whom may be small businesses, can benefit from vertical arrangements that protect their efforts to provide services from "free riding" by others. Furthermore, needless prohibition of beneficial, efficiency-enhancing vertical practices may work to the ultimate detriment of small businesses that operate as franchises, since manufacturers who are denied the means to achieve efficiencies through vertical restrictions may choose to abandon a franchise system in favor of vertical integration.

I would like also to discuss two other areas in which our enforcement policies are helpful to small businesses, namely, licensing restrictions placed on patents and other intellectual property and joint ventures. Small businesses traditionally have been a key source of new ideas and innovation in our economy, and they therefore have particular reason for concern that antitrust enforcement officials understand and respect the legitimate purposes behind patents and other forms of intellectual property. For example, patent rights for potential entrants into an established market may provide a competitive edge to counter larger, existing competitors' popular trade names, access to investment capital, or established marketing organizations. It is particularly important that firms be allowed freedom to exploit fully their legitimate patent rights in ways they find most efficient so long as their licensing practices do not threaten to suppress competition between the patented technology and substitutes for that technology. Accordingly, our case-by-case analysis is intended to distinguish those patent licensing provisions that are harmful to competition from those that enhance consumer welfare.

The Department also utilizes a similar fact-intensive, case-by-case approach to joint ventures. Although joint ventures can raise competitive concerns in particular situations, they often have beneficial aspects, such as fostering efficiencies not available to individual firms and promoting technological progress through synergistic innovative efforts. Unduly harsh rules suppressing the use of joint ventures may favor larger firms by denying smaller firms economies of scale they could attain only through the use of a joint venture.

Distinguishing anticompetitive joint ventures from beneficial ones requires inquiry into their scope relative to the markets in which the participants compete, as well as consideration of the existence of unnecessary collateral competitive restraints and the availability and desirability of access by others. The Department's Antitrust Guide Concerning Research Joint Ventures, published in 1980, is intended to assist businesses considering joint ventures by clarifying our enforcement policies in this area. For example, as the Guide indicates, an important consideration is whether a joint venture leaves a significant number of non-participating firms free to engage independently in research. If it does not, and if the joint venture's research could be done individually by the participating firms, antitrust problems could arise.

Mr. Chairman, that concludes my prepared remarks. I would be happy to respond to any questions you or any other member of the Committee or Subcommittee may have.

Department of Justice

FOR IMMEDIATE RELEASE
MONDAY, JUNE 14, 1982

AT
202-633-2016

Attached are copies of Attorney General William French Smith's statement announcing the new antitrust merger guidelines, the press release describing them, and the merger guidelines.

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MONDAY, JUNE 14, 1982

STATEMENT BY ATTORNEY GENERAL WILLIAM FRENCH SMITH RELEASING THE NEW DEPARTMENT OF JUSTICE MERGER GUIDELINES

Today I am pleased to announce the fulfillment of one of my major policy objectives as Attorney General -- the release of new Department of Justice Merger Guidelines. These Guidelines replace an earlier set issued in 1968.

This Administration is committed to a strong antitrust policy that will safeguard competition in our free enterprise economy. The American public is ill served, however, when unnecessary uncertainty about government enforcement standards inhibits otherwise lawful and procompetitive commercial transactions. Our new Merger Guidelines should reduce much of that uncertainty by delineating the general principles and specific standards used by the Antitrust Division in screening the hundreds of mergers that must be examined each year.

These Guidelines are the product of over a year of concentrated effort by a number of lawyers and economists within the Antitrust Division. In addition, we have benefited from comments by the staff of the Federal Trade Commission, and we thank them for their part in this effort. The Guidelines have already been transmitted to the members of the FTC, the Senate and House Judiciary Committees, and the Senate Small Business Committee.

The new Guidelines do not represent new policy for this Administration. They are instead a formal embodiment of the existing policy of aggressively prosecuting anticompetitive mergers. Some mergers pose serious competitive problems, but most do not. The purpose of the Guidelines is to tell the public how the Antitrust Division draws that line.

While the 1968 Guidelines expressly contemplated future revision, no formal changes were made during the intervening 14 years. During that time, however, new economic thinking and new judicial attitudes and decisions have rendered the 1968 Guidelines largely obsolete in important respects. Although comparison between the old and the new Guidelines is inevitable, the more important comparison is to the actual practice of the Department over recent years. Viewed in this light, the new Guidelines constitute an evolutionary change -- not a revolutionary change.

The process of writing the Guidelines has itself been useful to the Department in clarifying its own thinking about mergers. Constant interaction has occurred between the Guideline rewriting project and the staff analysis of actual merger cases. The Guidelines make eminent economic sense, but they also serve the important function of informing the public how the Antitrust Division analyzes specific merger situations.

As pleased as we are with this new statement on merger policy, the Guidelines should not be taken for more than they can be. A constant tension exists between the desire to include every relevant economic factor and the need to provide clear guidance to the business community. The Guidelines could therefore never fully cover every circumstance in which the Department would or would not challenge a merger. Nevertheless, their relative clarity, broad scope and economic reasonableness convince me that they will make an important and enduring contribution to this area of the law.

FOR IMMEDIATE RELEASE
MONDAY, JUNE 14, 1982

AT
202-633-2016

Attorney General William French Smith today announced guidelines which outline the standards now in use by the Department of Justice in determining what mergers it will challenge.

The new guidelines replace those issued by the Department in 1968. In 44 pages they outline the general principles and specific standards the Department's Antitrust Division uses in screening the hundreds of mergers it examines every year.

The Attorney General emphasized that the guidelines are not a comprehensive statement of the circumstances considered by the Department in determining whether to challenge a merger. Their purpose is to provide guidance to the business community, private lawyers and others in anticipating what standards will be used and how they will be applied. For that reason, he noted, they give as much attention to situations in which a challenge is unlikely as to those in which a challenge is likely.

Usually a challenge comes in the form of a civil suit by the Antitrust Division charging a violation of Section 7 of the Clayton Act or Section 1 of the Sherman Act -- both of which prohibit anticompetitive mergers. Such a suit often seeks divestiture of the acquired firm or one or more units of either firm in order to remove the anticompetitive problem. Such suits are frequently settled by consent decree. The Department generally requires prior elimination of the competitive problem before entering into such court-enforced settlements. Sometimes proposed mergers are abandoned after the Department threatens suit.

The 1968 Guidelines

Though it was made clear when the 1968 guidelines were issued that they would be revised as time went by, no formal changes were ever published. The standards employed in analyzing mergers have changed substantially since that time, however. For that reason, the new guidelines differ considerably from the old ones, although the new guidelines simply reflect the standards and policy now in use.

The 1968 guidelines dealt with three kinds of mergers -- horizontal, vertical and conglomerate. Horizontal mergers are those between competitors, such as two auto makers. Vertical mergers are those involving firms in the same supply chain, such as a manufacturer of a product and the distributor of the same product. Conglomerate mergers are those between firms in different lines of business or between firms in the same line of business in economically separate geographic regions.

The 1968 guidelines set forth standards for each of the three kinds of mergers. The new guidelines have only two categories -- horizontal and non-horizontal mergers.

The New Guidelines

The main purpose of the Department's merger enforcement is the prevention of mergers that make easier the exercise of market power -- the ability of one or more firms to raise prices above a competitive level. All the standards mentioned in the guidelines involve factors bearing on that ability. The purpose of the guidelines is to prevent the monopolization or cartelization -- control by one or by several firms -- of any significant economic markets.

In general the new guidelines may allow some horizontal mergers that the old guidelines would have challenged, and generally provide for the challenge of other mergers only where there are indications that there would be some horizontal effect, real or potential. In other words, they usually require an indication of harm to competition by affecting firms in competition with one another. Those changes reflect the gradual trends in judicial merger decisions and Department of Justice enforcement practices between 1968 and the beginning of the 1980's. In addition, the new guidelines reflect some changes in emphasis which began with this Administration in early 1981.

The purpose of the new guidelines is to reflect the current emphasis -- both in the Antitrust Division and in the courts -- on the need for economic evidence of harm or potential harm to competition before a merger will be challenged. The new guidelines were designed to quantify the standards applied to the extent that is practicable. Where numbers are not applicable, efforts were made to state in detail the kinds of factors that would be weighed.

In analyzing any merger, it is first necessary to determine the relevant market or markets in which competitive harm may occur as a result of the merger. For instance, two merging grocery chains may be operating nationally with direct competition in dozens of major cities. To remove the competitive problems of a merger it could be necessary for them to spin off to third parties one of the stores in each of those cities, so that the merger would no longer reduce competition. If, on the other hand, they were only in competition in two cities in the Midwest, the sale of one outlet in each of those two cities might solve the problem.

In determining whether or not the risk of harm to competition is enough to warrant a challenge by the Antitrust

Division, one of the most important factors is the level of concentration in that particular market, whether it be a national market for a particular drug or a local market for freshly baked doughnuts.

The Herfindahl Index

One significant change from the 1968 guidelines is the use of a different index to measure market concentration.

The 1968 guidelines used the four-firm concentration ratio to measure market shares. The four-firm concentration ratio is the sum of the percentage market shares of the top four firms in the market.

The new guidelines use the Herfindahl index instead. That index is calculated by squaring the percentage market share of each firm in the market and then adding those squares.

The Herfindahl index was chosen because it gives a more accurate measure of market structure than the four-firm concentration ratio. For instance, if there were a market in which four firms each had a 15 percent share and 40 firms each had a one percent share, and a second market where one firm had 57 percent of the market and the remaining 43 firms one percent each, the four-firm concentration ratios would be identical -- 60 percent each.

The Herfindahls for those two markets would be far from the same, however. The first market would have an index of 940 and the second an index of 3,292 -- more than three times as great. In the first market, the Department's concern about mergers would be relatively low, and in the second, quite high. In actually applying the Herfindahl index to a merger situation two figures are important -- the index of concentration after the merger, and how much that differs from the index before the merger.

Market Definition

A second significant change from the 1968 guidelines is the fact that the new guidelines discuss the process of market definition in considerable detail. Defining the relevant market is one of the most important steps in merger analysis, because what market is selected and how that market is defined can be vital in determining whether or not the merger is deemed anticompetitive enough to warrant challenge by the Antitrust Division.

Since the relevant market chosen for analysis is the foundation on which all later analysis depends, the principles applied in market definition should be consistent. Although market definition will always depend on the specific facts in each case, the guidelines describe general principles that will be applied consistently in this process, which will still involve a fair amount of judgment and discretion on the part of those making the analysis.

Throughout the section of the guidelines dealing with market definition is an emphasis on defining a market in terms of the underlying concern about market power that is the basis for the guidelines themselves. The goal of market definition is to identify and consider all the firms that would have to cooperate in order to raise prices above the competitive level and keep them there.

For instance, the guidelines suggest that in considering whether to include a particular product or firm in the market it may be useful to hypothesize a small price increase, and then consider whether such an action would be likely to cause customers to shift to a different supplier or a different product. If a sufficient number of customers would shift to a substitute product or another supplier to make a price increase unprofitable, the market probably needs to be expanded to include that product or that supplier.

Once the market is defined, the guidelines provide standards for analyzing the merger. The standards applied depend on whether the merger is horizontal -- in which the merging firms are in the same market -- or non-horizontal -- which includes all other mergers.

Since the bulk of mergers that pose competitive problems are horizontal ones, the guidelines focus primarily on them.

Horizontal Mergers

The standards applied to horizontal mergers fall into three general areas. They are the level of concentration in the market after the merger, the ease of entry by other firms into the market, and a series of factors bearing on the ease or profitability of collusion.

Market concentration is important because it is much easier to raise prices above a competitive level and keep them there in a highly concentrated market.

Ease of entry is important because if enough firms can enter by constructing new facilities or converting existing ones, an effort to increase price would not be profitable because other firms could be drawn in and drive prices down.

Ease and profitability of collusion are important because there is less likelihood that firms will try to get together to raise prices above a competitive level when it is difficult or unprofitable.

What Mergers Will Be Challenged

In analyzing market concentration in a horizontal merger the guidelines use the post-merger Herfindahl index to set forth three levels of concentration:

-- where the post merger market is "unconcentrated," that is, where even after the merger the Herfindahl is below 1,000. In such an "unconcentrated" market the Department would be unlikely to challenge any merger. An index of 1,000 indicates the level of concentration that exists, for instance, in a market shared equally by 10 firms.

-- where the post-merger market is "moderately concentrated," with an index between 1,000 and 1,800, a challenge would still be unlikely, provided the merger increases the index by less than 100 points. If the merger increases the index by more than 100 points, a challenge by the Antitrust Division would be more likely than not, with the decision being based on the extent of the increase, the ease of entry, and the presence or absence of other relevant factors specified in the guidelines.

-- where the post-merger market is "highly concentrated," resulting in an index above 1,800, challenge is unlikely where the merger produces an increase of less than 50 points. If the merger produces an increase in the index between 50 and 100 points, challenge is more likely than not, again depending on the size of the increase, ease of entry and other factors as specified. If the merger produces an increase in the index of more than 100 points, challenge is likely. An index of 1800 indicates the level of concentration that exists, for instance, in a market shared equally by approximately six firms (5.56 equally-sized firms, to be precise).

In addition, if the leading firm in the market has a market share of 35 percent or more and is about twice as large as the second largest firm or larger, the Department is likely to challenge a merger by the largest firm with any firm having at least one percent of the market. In such a case, the only possible mitigating factor to be considered by the Department would be easy of entry.

A shorthand way to calculate the increase in the Herfindahl index that would be created by any merger is to multiply the percentage shares of the two merging firms and then double the product. For instance, the merger of a 25 percent firm with a two percent firm would give an increase of 100 points (25 x 2 x 2), and the merger of two firms with seven percent each would yield an increase of 98 points (7 x 7 x 2).

Converted into the Herfindahl measurement, the 1968 guidelines stated that a challenge was likely for mergers that increased concentration by 30-40 points in highly concentrated markets (four-firm concentration of 75% or more) and by 50-90 points in less highly concentrated markets (four-firm concentration of less than 75%).

Unlike the new guidelines, however, the old guidelines did not state that mergers producing smaller increases in concentration would not be challenged. Similarly, the old guidelines did not recognize an unconcentrated region where challenges were generally unlikely.

New Entry

The inferences drawn from the concentration numbers above may be adjusted to take account of very easy entry to the market. The reason that ease of entry is so important is that where firms not already in the market can enter it very easily, inferences drawn from the post-merger concentration index can be misleading. Because ease of entry cannot be expressed in market statistics, it has to be looked at as an independent consideration but one which the guidelines make clear is very significant.

Other Factors

Compared to the old guidelines, the new guidelines identify a much larger number of additional factors that the Department will consider in deciding whether to challenge a merger.

The other factors to be considered are ones which might justify some adjustment in the inferences to be drawn from the post-merger concentration. The guidelines state that, where relevant, these factors will be used to resolve close cases.

These factors generally deal with the ease and profitability of collusion among sellers to raise prices above competitive levels. They fall into four rough categories, dealing with:

-- the nature of the product and the terms of sale;

-- availability to firms in the market of information about specific transactions and buyer market characteristics;

-- conduct of firms in the market;

-- market performance.

Within each category, the relevance of the factors to the likelihood of collusion is explained. For instance, with homogeneous products, the number of issues on which competitors must agree in order to raise prices is smaller, thus making effective collusion more likely.

Factors that may make a challenge more likely include:

-- extreme homogeneity of product;

-- substantial gaps between the products in the market and the next best substitute;

-- particularly strong similarities in the products of the merging firms compared to the products of other firms in the market;

-- readily accessible information about specific transactions in the market;

-- a market for the product in which buyers' orders are frequent, regular and small compared to the total output of the typical firm in the market;

-- evidence of prior horizontal collusion among firms in the market;

-- use by substantially all the firms in the market of mandatory delivered pricing, or exchange of sensitive price or output information, or collective standardization of characteristics of the product which were at one time the basis for competition, or price protection clauses, or the fact that the acquired firm has been an unusually competitive force in the market, or the fact that before the merger the market appears to be operating in a non-competitive way.

The only factor discussed in the horizontal section that would make a challenge less likely is extreme heterogeneity of the relevant product. A footnote, however, points out that a similar situation may exist where there is rapid technological change or where supply arrangements consist of many complicated terms in addition to price. Those three factors make successful collusion more difficult.

Non-horizontal Mergers

The guidelines make clear that although non-horizontal mergers are less likely to harm competition, they are not always innocuous. They make plain that much of what is said about horizontal mergers could also be applied to non-horizontal mergers -- such as the discussion of market concentration, ease of entry and other factors -- and they discuss five non-horizontal theories of liability.

The five non-horizontal theories of liability under which such mergers might be challenged are:

-- the elimination of specific potential entrants into the market;

-- the creation of barriers to entry to the market through vertical mergers;

-- the facilitation of collusion through vertical mergers which integrate the firms to include the retail level;

-- the elimination through vertical merger of a disruptive buyer;

-- the evasion of rate regulation.

For each of the five theories the guidelines describe the possible harm and the conditions necessary for that harm to occur.

Defenses

In a concluding section dealing with defenses to an antitrust challenge to a merger, the guidelines indicate that only in extraordinary cases will the Department consider a claim of efficiencies as a mitigating factor to a merger that would otherwise be challenged. They also indicate that a stringent analysis will be applied to the so-called "failing firm" defense, a doctrine which may immunize otherwise anticompetitive mergers. Before recognizing the defense, the Department will require that the failure of the firm is very likely and that no less anticompetitive acquisition be available.

Conclusion

The guidelines do not oblige the Department or the Antitrust Division to consider or ignore any factors in analyzing mergers. That consideration will still, as in the past, require the exercise of judgment and discretion. The purpose of the guidelines is to reduce uncertainty to the reasonable minimum consistent with an uncertain and evolving area. For those seeking more certainty as to the Department's enforcement intent, specific proposed conduct may be described to the Department as part of the Business Review Letter procedure, and a letter dealing with the enforcement intent of the Department, where appropriate, will be sent in return.

The guidelines represent more than a year of work by the economists and lawyers of the Antitrust Division, and were prepared at the direction of, and with the active involvement of, William F. Baxter, Assistant Attorney General in charge of the Antitrust Division.

U.S. DEPARTMENT OF JUSTICE
MERGER GUIDELINES

ISSUED: June 14, 1982

I. PURPOSE AND UNDERLYING POLICY ASSUMPTIONS

These Guidelines state in outline form the present enforcement policy of the U.S. Department of Justice ("Department") concerning acquisitions and mergers ("mergers") subject to section 7 of the Clayton Act 1/ or to section 1 of the Sherman Act. 2/ They describe the general principles and specific standards normally used by the Department in analyzing mergers. 3/ By stating its policy as simply and clearly as possible, the Department hopes to reduce the uncertainty associated with enforcement of the antitrust laws in this area.

Although the Guidelines should improve the predictability of the Department's merger enforcement policy, it is not possible to remove the exercise of judgment from the evaluation of mergers under the antitrust laws. Difficult factual questions arise under the standards stated below, and the Department necessarily will base its decision on the data that are practicably available in each case. Moreover, the

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1/ 15 U.S.C.A. § 18 (1981). Mergers subject to section 7 are prohibited if their effect "may be substantially to lessen competition, or to tend to create a monopoly."

2/ 15 U.S.C.A. § 1 (1981). Mergers subject to section 1 are prohibited if they constitute a "contract, combination . . ., or conspiracy in restraint of trade."

3/ They replace a set of Guidelines issued by the Department in 1968, and are subject to further revision in light of subsequent judicial decisions or economic studies. Although changes in enforcement policy may precede the issuance of amended Guidelines, the Department will attempt to conform the Guidelines to such changes as soon as possible.

standards represent generalizations to which some exceptions are inevitable. In appropriate cases, the Department will challenge mergers that are competitively objectionable under the general principles of the Guidelines regardless of whether they are covered by the specific standards. Finally, the Guidelines are designed primarily to indicate when the Department is likely to challenge mergers, not how it will conduct the litigation of cases that it decides to bring. Although relevant in the latter context, the factors contemplated in the standards do not exhaust the range of evidence that the Department may introduce in court. 4/

The unifying theme of the Guidelines is that mergers should not be permitted to create or enhance "market power" or to facilitate its exercise. A sole seller (a "monopolist") of a product with no good substitutes can maintain a selling price that is above the level that would prevail if the market were competitive. Where only a few firms account for most of the sales of a product, those firms can in some circumstances coordinate, explicitly or implicitly, their actions in order to approximate the performance of a monopolist. This ability of

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4/ Parties seeking more specific advance guidance concerning the Department's enforcement intentions with respect to any particular merger should consider using the Business Review Procedure. 28 C.F.R. § 50.6.

one or more firms profitably to maintain prices above competitive levels for a significant period of time is termed "market power." Sellers with market power also may eliminate rivalry on variables other than price. In either case, the result is a transfer of wealth from buyers to sellers and a misallocation of resources. 5/

Although they sometimes harm competition, mergers generally play an important role in a free enterprise economy. They can penalize ineffective management and facilitate the efficient flow of investment capital and the redeployment of existing productive assets. While challenging competitively harmful mergers, the Department seeks to avoid unnecessary interference with that larger universe of mergers that are either competitively beneficial or neutral. In attempting to mediate between these dual concerns, however, the Guidelines reflect the congressional intent that merger enforcement should interdict competitive problems in their incipiency.

II. MARKET DEFINITION AND MEASUREMENT

Using the standards stated below, the Department will define and measure the market for each product or service ("product") of each of the merging firms. A market is a group

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5/ "Market power" also encompasses the ability of a single buyer or group of buyers to depress the price paid for a product to a level that is below the competitive price. Market power by buyers has wealth transfer and resource misallocation effects analogous to those associated with market power by sellers.

of products and an associated geographic area with certain economic characteristics that will be described in subsequent paragraphs. In theory, all the demand and supply forces relevant to the evaluation of a merger could be incorporated in the definition of a market. Under the Guidelines, however, market definition is not the exclusive analytical technique through which the Department considers those forces. For example, because the potential new entry from the construction of new facilities and from the substantial modification of existing facilities is not easily captured in conventional market statistics, the Department takes such entry into account in interpreting market statistics. 6/ Taken as a whole, however, the standards in the Guidelines are designed to ensure that, whenever the Department challenges a merger, the firms in the affected market could exercise market power if they were able to coordinate their actions.

A. Product Market Definition

The first task in market definition is to determine what products to include in the market for the product of the

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6/ In contrast to the comprehensive definition suggested in this paragraph of the text, the market definition used by the Department can be stated formally as follows: "a market consists of a group of products and an associated geographic area such that (in the absence of new entry) a hypothetical, unregulated firm that made all the sales of those products in that area could increase its profits through a small but significant and non-transitory increase in price (above prevailing or likely future levels)." The standards for market definition in the text below implement this definition.

merging firm. 7/ In general, the Department seeks to identify a group of products such that a hypothetical firm 8/ that was the only present and future seller of those products could raise price profitably. That is, assuming that buyers could respond to an increase in price for a tentatively identified product group only by shifting to other products, what would happen? If readily available alternatives were, in the aggregate, sufficiently attractive to enough buyers, an attempt to raise price would not prove profitable, and the "market" would prove to have been too narrowly defined.

Taking the product of the merging firm as a beginning point, the Department will establish a provisional product market. The Department will include in the provisional market those products that the merging firm's customers view as good substitutes at prevailing prices. 9/ The potential weakness of such a market based solely on existing patterns of supply and demand is that those patterns might change substantially if the prices of the products included in the provisional market were

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7/ The analysis that follows will be repeated for each product of each merging firm.

8/ In Sections III(A) and III(C), the Guidelines discuss factors affecting the ability of a group of sellers, by coordinating their actions, to approximate the performance of a single firm.

9/ On occasion, the Department may base this analysis on likely future prices, provided that the relevant price relationships can be projected with confidence.

to increase. For this reason, the Department will test furthe and, if necessary, expand the provisional market. The Department will add additional products to the market if a significant percentage of the buyers of products already included would be likely to shift to those other products in response to a small but significant and non-transitory increase in price. As a first approximation, the Department will hypothesize a price increase of five percent and ask how many buyers would be likely to shift to the other products within one year. 10/ The Department will continue expanding the provisional market until it satisfies the general profitability standard stated above. 11/

10/ The purpose of hypothesizing a price increase is to interject a dynamic element in the analysis as a conceptual aid in determining the outer limits of the market. Judged by the effect on rate of return on invested capital, a given percentage price increase may be much more significant in some industries than in others.

Direct evidence of the likely effect of a price increase often will not be available, particularly in the context of the Department's prelitigation evaluation of a merger. As a result, the Department often will have to rely on inferences from the types of circumstantial evidence described in the text below. For consistency, the Department will assume that buyers and sellers immediately recognize the price increase and believe that it will be sustained for the foreseeable future.

11/ The Department normally will not expand the market beyond the point at which this standard is satisfied unless it is convinced that independent competitive concerns exist in a larger market.

In evaluating product substitutability, 12/ the Department will consider any relevant evidence, but will give particular weight to the following factors:

1) Evidence of buyers' perceptions that the products are or are not substitutes, particularly if those buyers have shifted purchases between the products in response to changes in relative price or other competitive variables;

2) Similarities or differences between the products in customary usage, design, physical composition and other technical characteristics;

3) Similarities or differences in the price movements of the products over a period of years; and

4) Evidence of sellers' perceptions that the products are or are not substitutes, particularly if business decisions have been based on those perceptions.

The analysis of product market definition to this point has assumed that price discrimination--charging different buyers different prices for products having the same cost, for example--would not be possible after the merger. Existing buyers sometimes will differ significantly in their assessment

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12/ In constructing and expanding the provisional market, the Department will not exclude any product that is at least as good a substitute as any product included. The Department will refer to the products included in the market collectively as the "relevant product."

of the adequacy of a particular substitute and the ease with which they could substitute it for the product of the merging firm. Even though a general increase in price might cause such significant substitution that it would not be profitable, sellers who can price discriminate could raise price only to groups of buyers who cannot easily substitute away. 13/ If such price discrimination is possible, the Department will consider defining additional, narrower relevant product markets oriented to the buyer groups subject to the exercise of market power. 14/

B. Identification of Firms that Produce the Relevant Product

In most cases, the Department's evaluation of a merger will focus primarily on firms that currently produce and sell the relevant product. In addition to those firms, however, the

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13/ Price discrimination requires that sellers be able to identify those buyers and that other buyers be unable profitably to purchase and resell to them.

14/ Price discrimination is discussed in the Guidelines because it is sometimes a manifestation of market power created by a merger. In the context described in the text, a price increase to one group of buyers, reducing quantities purchased by that group, will not be accompanied by a price reduction and output increase to the other group. Hence, its effects on consumer welfare are unambiguously negative. It is important to distinguish that situation from the one in which a firm already possesses market power and is likely to exercise it, whether or not it is able to practice price discrimination. In the latter situation, price discrimination often results in an expansion of output, thus reducing the resource misallocation associated with market power.

Department may include additional firms in the market in certain circumstances. 15/

1. Production Substitution. The same productive and distributive facilities can sometimes be used to produce and sell two or more products that buyers do not regard as good substitutes. Production substitution refers to the shift by a firm in the use of facilities from producing and selling one product to producing and selling another. Depending upon the cost and speed of that shift, production substitution may allow firms that do not currently produce the relevant product to respond effectively to an increase in the price of that product. 16/

15/ The situations described in the text below are particularly subject to difficult questions of degree. In such cases, it is often useful to calculate market shares based on alternative reasonable assumptions--for example, with and then without a particular type of facility arguably capable of easy and economical production substitution. In its evaluation of such cases, the Department will take into account the closeness of the issue, whichever way it is resolved for calculation of market statistics.

16/ Under other analytical approaches, production substitution sometimes has been reflected in the description of the product market. For example, the product market for stamped metal products such as automobile hub caps might be described as "light metal stamping," a production process rather than a product. The Department believes that the approach described in the text provides a more clearly focused method of incorporating this factor in merger analysis. If production substitution among a group of products is nearly universal among the firms selling one or more of those products, however, the Department may use an aggregate description of those markets as a matter of convenience.

If a firm has existing productive and distributive facilities that could easily and economically be used to produce and sell the relevant product within six months in response to a small but significant and non-transitory increase in price, the Department will include those facilities in the market. 17/ As a first approximation, the Department will hypothesize a price increase of five percent and ask how many firms would be likely to change to the production and sale of the relevant product within six months. 18/ Firms that must construct significant new productive or distributive facilities in order to produce and sell the relevant product will not be included in the market, although the Department will consider their competitive significance in evaluating entry conditions generally. 19/

2. Durable Products. Some long-lived products may continue to exert competitive influence after the time of original sale. If, under the standards stated in Section II(A), recycled or reconditioned products represent good substitutes for new products, the Department will include in the market firms which recycle or recondition those products.

17/ The amount of sales or capacity to be included in the market is a separate question discussed in Section II(D), below.

18/ See note 10, above.

19/ See Section III(B), below.

3. Internal Consumption. Captive production and consumption of the relevant product by vertically integrated firms are part of the overall market supply and demand. Such firms are free to buy or sell in the market, and they incur an opportunity cost for units they consume rather than sell. The increase in that cost resulting from an increase in the market price may induce a change in behavior. The Department will include in the market the facilities that are used to produce the relevant product. 20/

C. Identification of Firms that Produce the Relevant Product at Relevant Locations (Geographic Market Definition)

For each product market of each merging firm, the Department will determine the geographic market(s) in which that firm sells. The purpose of geographic market definition is to establish a geographic boundary that roughly separates firms that are important factors in the competitive analysis of a merger from those that are not. Depending on the nature of the product, the geographic market may be as small as a part of a city or as large as the entire world. Moreover, a single firm may operate in a number of economically discrete geographic markets.

20/ See note 17, above. In evaluating the competitive significance of internally consumed production, the Department will consider whether the vertically integrated firm, either through sales of the relevant product or through sales of the products in which the relevant product is embodied, could frustrate an effort by the sellers of the relevant product to exercise market power.

In general, the Department seeks to identify a geographic area such that a hypothetical firm that was the only present or future producer of the relevant product in that area could profitably raise price. That is, assuming that buyers could respond to a price increase within a tentatively identified area only by shifting to firms located outside the area, what would happen? If firms located elsewhere readily could provide the relevant product to the hypothetical firm's buyers in sufficient quantity at a comparable price, an attempt to raise price would not prove profitable, and the "market" would prove to have been too narrowly defined.

Taking the location of the merging firm (or each plant, for multi-plant firms) as a beginning point, the Department will establish a provisional geographic market based upon the shipment patterns of that firm and its closest competitors. 21/ The potential weakness of such a market boundary based on existing patterns of supply and demand is that those patterns might change substantially if the price within the provisional market were to increase. For this reason, the Department will test further and, if necessary, expand the provisional market. The Department will expand the provisional market boundaries to

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21/ Because the definition of geographic markets in the Guidelines is an area derived from the location of sellers' facilities, the area may not always exhibit characteristics associated with traditional geographic market definitions that are based, in whole or part, on buyer locations. Nevertheless, as a rule of thumb, the merging firm should make a significant percentage of its sales in the provisional market and firms located outside it collectively should account for a small percentage of total sales there. It is possible that a geographic market could include only one firm.

include the locations of firms (or plants) that could make significant sales to customers of firms previously included in the provisional market in response to a small but significant and non-transitory increase in price. As a first approximation, the Department will hypothesize a price increase of five percent and ask how many sellers could sell the product to such customers within one year. 22/ The Department will continue expanding the provisional market until it satisfies the general profitability standard stated above. 23/

In evaluating geographic substitutability, 24/ the Department will consider any relevant evidence, but will give particular weight to the following factors:

1) Evidence of buyers actually having shifted their purchases among sellers at different geographic locations, especially if the shifts corresponded to changes in relative price or other competitive variables;

2) Similarities or differences in the price movements of the relative product in different geographic areas over a period of years;

22/ See note 10, above. In some cases, a general expansion of the market boundaries may overstate the likely supply response. If a specific firm has a particular ability to sell in the provisional market that is not shared by other firms in that firm's area, the Department will treat that firm alone as being in the market.

23/ See note 11, above.

24/ In constructing and expanding the provisional market, the Department will not exclude any area if production there is at least as good a substitute as production that is included.

3) Transportation costs;

4) Costs of local distribution; and

5) Excess capacity by firms outside the provisional market.

The analysis of geographic market definition to this point has assumed that geographic price discrimination--charging different prices net of transportation costs for the same product to buyers in different locations, for example--would not be possible after the merger. As in the case of product market definition, however, where price discrimination is possible, 25/ the Department will consider defining additional, narrower geographic markets oriented to those buyer groups subject to the exercise of market power.

In general, the standards stated above will govern geographic market definition, whether domestic or international. The Department, however, will be somewhat more cautious, both in expanding market boundaries beyond the United States and in assessing the likely supply response of specific foreign firms. Although firms located outside the United States may exert an important competitive influence on domestic prices, they may be subject to additional constraints not present in the purely domestic context. For example, changes

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25/ See notes 13-14, above. Geographic price discrimination against a group of buyers is more likely when other buyers cannot easily purchase and resell the relevant product to them. Such arbitrage is particularly difficult where the product is sold on a delivered basis and where transportation costs are a significant percentage of the final cost.

in exchange rates, tariffs, and general political conditions may limit the ability of such firms to respond to domestic price increases.

D. Calculating Market Shares

The Department normally will include in the market the total sales or capacity 26/ of all firms (or plants) that are identified as being in the market in Sections II(B) and II(C). In some cases, however, total sales or capacity may overstate the competitive significance of a firm. With respect to firms included in the market under Sections II(B)(1) (production substitution) and II(B)(3) (internal consumption), for example, the Department will include only those sales likely to be made or capacity likely to be used in the geographic market in response to a small but significant and non-transitory increase in price. As a first approximation, the Department will hypothesize a price increase of five percent and ask what the likely response of the firms would be within one year. 27/

26/ Market shares can be expressed in terms of dollar sales, physical unit sales, physical capacity, or (in natural resource industries) physical reserves. The availability of data often will determine the measurement base. Where a choice is possible, the Department will use the measurement base that is the best indicator of the likely effect of the merger on market power.

27/ See note 10, above. It follows that some firms included in the market might have little or no sales or capacity attributed to them. Conversely, the present sales or capacity of a firm may understate its competitive significance. This effect is most likely in the acquisition of new or as-yet-unexploited patent rights.

Similarly, a firm's capacity may be so committed elsewhere that it would not be available to respond to an increase in price in the market. In such cases, the Department also may include a smaller part of the firm's sales or capacity.

III. HORIZONTAL MERGERS

Where the merging firms are in the same product and associated geographic market, the merger is horizontal. In such cases, the Department will focus first on the post-merger concentration of the market and the market shares of the merging firms. In some cases with low post-merger market concentration and/or market shares, the Department will be able to determine without a detailed examination of other factors that the merger poses no significant threat to competition. In other cases, however, the Department will proceed to examine a variety of other factors relevant to that question.

A. Concentration and Market Share

Market concentration is a function of the number of firms in a market and their respective market shares. 28/ Other things being equal, concentration affects the likelihood that one firm, or a small group of firms, could successfully exercise market power. The smaller the percentage of total supply that a firm controls, the more severely it must restrict

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28/ Markets can range from atomistic, where very large numbers of firms that are small relative to the overall size of the market compete with one another, to monopolistic, where one firm controls the entire market. Far more common, and more difficult analytically, is the large middle range of instances where a relatively small number of firms account for most of the sales in the market.

its own output in order to produce a given price increase, and the less likely it is that an output restriction will be profitable. Where collective action is necessary, an additional constraint applies. As the number of firms necessary to control a given percentage of total supply increases, the difficulties and costs of reaching and enforcing consensus with respect to the control of that supply also increase.

As an aid to the interpretation of market data, the Department will use the Herfindahl-Hirschman Index ("HHI") of market concentration. The HHI is calculated by summing the squares of the individual market shares of all the firms included in the market under the standards in Section II. 29/ Unlike the traditional four-firm concentration ratio, the HHI reflects both the distribution of the market shares of the top four firms and the composition of the market outside the top four firms. It also gives proportionately greater weight to the market shares of the larger firms, which probably accords with their relative importance in any collusive interaction.

The Department divides the spectrum of market concentration as measured by the HHI into three regions that can be broadly characterized as unconcentrated (HHI below 1000), moderately

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29/ For example, a market consisting of four firms with market shares of 30 percent, 30 percent, 20 percent and 20 percent has an HHI of 2600 ($30^2 + 30^2 + 20^2 + 20^2 = 2600$). The HHI ranges from 10,000 (in the case of a pure monopoly) to a number approaching zero (in the case of an atomistic market). Although it is desirable to include all firms in the calculation, lack of information about small fringe firms is not critical because such firms do not affect the HHI significantly.

concentrated (HHI between 1000 and 1800) and highly concentrated (HHI above 1800). An empirical study by the Department of the size dispersion of firms within markets indicates that the critical HHI thresholds at 1000 and 1800 correspond roughly to four-firm concentration ratios of 50 percent and 70 percent, respectively. Although the resulting regions provide a useful format for merger analysis, the numerical divisions suggest greater precision than is possible with the available economic tools and information. Other things being equal, cases falling just above and just below a threshold present comparable competitive concerns.

1. General Standards. In evaluating horizontal mergers, the Department will consider both the post-merger market concentration and the increase in concentration resulting from the merger. 30/ The link between concentration and market power is explained above. The increase in concentration is relevant to several key issues. Although mergers among small firms increase concentration, they are less likely to have anticompetitive consequences. Moreover, even in concentrated

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30/ The increase in concentration as measured by the HHI can be calculated independently of the overall market concentration by doubling the product of the market shares of the merging firms. For example, the merger of firms with shares of 5 percent and 10 percent of the market would increase the HHI by 100 (5 x 10 x 2 = 100). [The explanation for this technique is as follows: In calculating the HHI before the merger, the market shares of the merging firms are squared individually. Thus: $(a)^2 + (b)^2$. After the merger, the sum of those shares would be squared. Thus: $(a + b)^2$, which equals $a^2 + 2ab + b^2$. The increase in the HHI therefore is represented by 2ab.]

markets, it is desirable to allow firms some scope for merger activity in order to achieve economies of scale and to permit exit from the market.

The general standards for horizontal mergers are as follows:

a) Post-Merger HHI Below 1000. Markets in this region generally would be considered to be unconcentrated, having the equivalent of at least 10 equally sized firms. Because implicit coordination among firms is likely to be difficult and because the prohibitions of section 1 of the Sherman Act are usually an adequate response to any explicit collusion that might occur, the Department is unlikely to challenge mergers falling in this region.

b) Post-Merger HHI Between 1000 and 1800. Because this region extends from the point at which the competitive concerns associated with concentration become significant to the point at which they become quite serious, generalization is particularly difficult. The Department, however, is unlikely to challenge mergers producing an increase in the HHI of less than 100 points. 31/ The Department is more likely than not to challenge mergers in this region that produce an increase in the HHI of more than 100 points. In making that decision, however, the Department will take into account the post-merger

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31/ Mergers producing increases in concentration close to the 100 point threshold include those between firms with market shares of 25 percent and 2 percent, 16 percent and 3 percent, 12 percent and 4 percent, 10 percent and 5 percent, 8 percent and 6 percent, and 7 percent and 7 percent.

concentration of the market, the size of the resulting increase in concentration, and the presence or absence of the other factors discussed in Sections III(B) and III(C).

c) Post-Merger HHI Above 1800. Markets in this region generally are considered to be highly concentrated, having the equivalent of no more than approximately six equally sized firms. Additional concentration resulting from mergers is a matter of significant competitive concern, and the Department will resolve close questions in favor of challenging the merger. The Department is unlikely, however, to challenge mergers producing an increase in the HHI of less than 50 points. 32/ For mergers producing an increase in the HHI of from 50 to 100 points, the Department will base its decision whether to challenge the merger on the post-merger concentration of the market, the size of the resulting increase in concentration, and the presence or absence of the factors discussed in Sections III(B) and III(C). The Department is likely to challenge mergers in this region that produce an increase in the HHI of 100 points or more. 33/

32/ Mergers producing increases in concentration close to the 50 point threshold include those between firms with market shares of 12 percent and 2 percent, 8 percent and 3 percent, 6 percent and 4 percent, and 5 percent and 5 percent.

33/ There is some economic evidence that, where one or two firms dominate a market, the creation of a strong third firm enhances competition. The Department has considered this evidence but is not presently prepared to balance this possible gain against the certainty of substantially increased concentration in the market.

2. Leading Firm Proviso. In some cases, typically where one of the merging firms is small, mergers that may create or enhance the market power of a single dominant firm could pass scrutiny under the standards stated in Section III(A)(1). Notwithstanding those standards, the Department is likely to challenge the merger of any firm with a market share of at least 1 percent with the leading firm in the market, provided that the leading firm has a market share that is at least 35 percent and is approximately twice as large as that of the second largest firm in the market. Because the ease and profitability of collusion are of little relevance to the ability of a single dominant firm to exercise market power, the Department will not consider the factors discussed in Section III(C) in this context. Under this standard, an ample market for small acquisitions typically will remain, and it is unlikely that any relevant economies will be limited to mergers involving the largest firm in the market.

B. Ease of Entry.

If entry into a market is so easy that existing competitors could not succeed in raising price for any significant period of time, the Department is unlikely to challenge mergers in that market. Under the standards in Section II(B)(1), firms that do not presently sell the relevant product, but that could easily and economically sell it using existing facilities, are included in the market and are assigned a market share. This section considers the additional competitive effects of (1) production substitution where the necessary modifications are more substantial, and (2) entry through the construction of new facilities.

In assessing ease of entry to a market, the Department will consider the likelihood and probable magnitude of entry in response to a small but significant and non-transitory increase in price. 34/ As a first approximation, the Department will hypothesize a price increase of five percent and ask how much new entry would be likely to occur within two years. 35/ In most cases in which significant entry is unlikely, the Department will not attempt to differentiate further the degrees of difficulty of entry. In cases where entry is unusually difficult, however, the Department is more likely to challenge a merger.

C. Other Factors

A variety of factors other than concentration, market shares, and ease of entry affect the likelihood that a merger will create, enhance or facilitate the exercise of market

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34/ See note 10, above. In general, entry is more likely when the additional assets necessary to produce the relevant product are short-lived or widely used outside the particular market. Conversely, entry is less likely when those assets are long-lived and highly specialized to the particular application. Entry is generally facilitated by the growth of the market and hindered by its stagnation or decline. Entry also is hindered by the need for scarce special skills or resources and the need to achieve a substantial market share in order to realize important economies of scale. See also Section IV(B)(1)(b), below.

35/ Although this type of supply response will take longer to materialize than those previously considered, its prospect may have a greater deterrent effect on the exercise of market power by present sellers. Where new entry involves the dedication of long-lived assets to a market, the resulting capacity and its adverse effects on profitability will be present in the market until those assets are depreciated.

power. In evaluating mergers, the Department will consider the following factors as they relate to the ease and profitability of collusion. Where relevant, the factors are most likely to be important where the Department's decision whether to challenge a merger is otherwise close.

1. Nature of the Product and Terms of Sale.

(a) Homogeneity-Heterogeneity of the Relevant Product Generally. In a market with a homogeneous and undifferentiated product, a cartel need establish only a single price--a circumstance that facilitates reaching consensus and detecting deviation. As the products which constitute the relevant product become more numerous, heterogeneous, or differentiated, however, the problems facing a cartel become more complex. Instead of a single price, it may be necessary to establish and enforce a complex schedule of prices corresponding to gradations in actual or perceived quality attributes among the competing products. 36/

Product variation is arguably relevant in all cases, but practical considerations dictate a more limited use of the factor. There is neither an objective index of product variation nor an empirical basis for its use in drawing fine distinctions among cases. As a result, this factor will be taken into account only in relatively extreme cases where both

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36/ A similar situation may exist where there is rapid technological change or where supply arrangements consist of many complicated terms in addition to price.

identification and effect are more certain. For example, when the relevant product is completely homogeneous and undifferentiated, the Department is more likely to challenge the merger. Conversely, when the relevant product is very heterogeneous or sold subject to complex configuration options or customized production, the Department is less likely to challenge the merger. 37/ Over a significant middle range of the spectrum of product variation, this factor is less likely to affect the Department's analysis.

b) Degree of Difference Between the Products and Locations in the Market and the Next-Best-Substitutes. The market definition standards stated in Section II require drawing relatively bright lines in order to determine the products and sellers to be considered in evaluating a merger. For example, in defining the relevant product, all "good substitutes" in demand are included. The profitability of any collusion that might occur will depend in part, however, on the quality of the next-best substitute. That is, it matters whether the next-best substitute is only slightly or significantly inferior to the last product included in the relevant product. Similarly, it matters whether the next-most-distant seller is only slightly or significantly

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37/ This conclusion would not apply, however, where the significance of heterogeneity is substantially reduced through detailed specifications that are provided by the buyer and that form the basis for all firms' bids.

farther away than the last seller included in the geographic market. The larger the "gap" at the edge of the product and geographic markets, the more likely the Department is to challenge the merger.

c) Similarities and Differences in the Products and Locations of the Merging Firms. There also may be relevant comparisons among the products or sellers included in the market. Where products in a relevant market are differentiated or sellers are spatially dispersed, individual sellers usually compete more directly with some rivals than with others. In markets with highly differentiated products, the Department will consider the extent to which consumers perceive the products of the merging firms to be relatively better or worse substitutes for one another than for other products in the market. In markets with spatially dispersed sellers and significant transportation costs, the Department will consider the relative proximity of the merging firms. If the products or plants of the merging firms are particularly good substitutes for one another, the Department is more likely to challenge the merger.

2. Information About Specific Transactions and Buyer Market Characteristics. Collusive agreements are more likely to persist if participating firms can quickly detect and retaliate against deviations from the agreed prices or other conditions. Such deviations are easiest to detect, and therefore least likely to occur, in markets where detailed

information about specific transactions or individual price or output levels is readily available to competitors. The Department is more likely to challenge a merger if such detailed information is available to competitors, whether the information comes from an exchange among sellers, public disclosure by buyers, reporting by the press or a government agency, or some other source.

Certain buyer market characteristics also may facilitate detection of deviation from collusive agreements. If orders for the relevant product are frequent, regular and small relative to the total output of a typical firm in the market, collusion is more likely to succeed because the benefits of departing from the collusive agreement in any single transaction are likely to be small relative to the potential costs. In order to increase its sales significantly in such circumstances, a seller would have to depart from the collusive agreement on a large number of orders. Each such sale takes customers away from other parties to the agreement, a fact that is particularly evident when demand is stable or declining. As a result, the chances of detection and effective response by other sellers increase with the number of such sales. The Department is more likely to challenge a merger where such buyer market characteristics exist.

3. Conduct of Firms in the Market. The Department is more likely to challenge a merger in the following circumstances:

a) Firms in the market previously have been found to have engaged in horizontal collusion regarding price, territories, or customers, and the characteristics of the market have not changed appreciably since the most recent finding. The additional concentration resulting from the merger could make explicit collusion more difficult to detect or tacit collusion more feasible.

b) One or more of the following types of practices are adopted by substantially all of the firms in the market: i) mandatory delivered pricing; ii) exchange of price or output information in a form that could assist firms in setting or enforcing an agreed price; iii) collective standardization of product variables on which the firms could compete; and iv) price protection clauses. Although not objectionable under all circumstances, these types of practices tend to make collusion easier, and their widespread adoption by the firms in the market raises some concern that collusion may already exist.

c) The firm to be acquired has been an unusually disruptive and competitive influence in the market. Before invoking this factor, the Department will determine whether the market is one in which performance might plausibly deteriorate because of the elimination of one disruptive firm.

4. Market Performance. When the market in which the proposed merger would occur is currently performing non-competitively, the Department is more likely to challenge the merger. Non-competitive performance suggests that the firms in the market already have succeeded in overcoming, at least to some extent, the obstacles to effective collusion. Additional concentration of such a market through merger could further facilitate the collusion that already exists. When the market in which the proposed merger would occur is currently performing competitively, however, the Department will apply its ordinary standards of review. The fact that the market is currently competitive casts little light on the likely effect of the merger.

In evaluating the performance of a market, the Department will consider any relevant evidence, but will give particular weight to the following evidence of possible non-competitive performance when the factors are found in conjunction:

a) Stable relative market shares of the leading firms in recent years;

b) Declining combined market share of the leading firms in recent years; 38/ and

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38/ The exercise of market power often results in a gradual loss of market share. Fringe firms find it possible and profitable to expand their sales, and new entry may occur.

c) Profitability of the leading firms over substantial periods of time that significantly exceeds that of firms in industries comparable in capital intensity and risk.

IV. HORIZONTAL EFFECT FROM NON-HORIZONTAL MERGERS

By definition, non-horizontal mergers involve firms that do not operate in the same market. It necessarily follows that such mergers produce no immediate change in the level of concentration in any relevant market as defined in Section II. Although non-horizontal mergers are less likely than horizontal mergers to create competitive problems, they are not invariably innocuous. This Section describes the principal theories under which the Department is likely to challenge non-horizontal mergers.

A. Elimination of Specific Potential Entrants

1. The Theory of Potential Competition. In some circumstances, the non-horizontal merger 39/ of a firm already in a market (the "acquired firm") with a potential entrant to that market (the "acquiring firm") 40/ may adversely affect competition in the market. If the merger effectively removes the acquiring firm from the edge of the market, it could have either of the following effects:

39/ Under traditional usage, such a merger could be characterized as either "vertical" or "conglomerate," but the label adds nothing to the analysis.

40/ The terms "acquired" and "acquiring" refer to the relationship of the firms to the market of interest, not to the way the particular transaction is formally structured.

a) Harm to "Perceived Potential Competition". By eliminating a significant present competitive threat that constrains the behavior of the firms already in the market, the merger could result in an immediate deterioration in market performance. The economic theory of limit pricing suggests that monopolists and groups of colluding firms may find it profitable to restrain their pricing in order to deter new entry that is likely to push prices even lower by adding capacity to the market. If the acquiring firm had unique advantages in entering the market, the firms in the market might be able to set a new and higher price after the threat of entry by the acquiring firm was eliminated by the merger.

b) Harm to "Actual Potential Competition". By eliminating the possibility of entry by the acquiring firm in a more pro-competitive manner, the merger could result in a lost opportunity for improvement in market performance resulting from the addition of a significant competitor. The more pro-competitive alternatives include both new entry and entry through a "toehold" acquisition of a present small competitor.

2. Relation Between Perceived and Actual Potential Competition. If it were always profit-maximizing for incumbent firms to set price in such a way that all entry was deterred and if information and coordination were sufficient to implement this strategy, harm to perceived potential competition would be the only competitive problem to address. In

practice, however, actual potential competition has independent importance. Firms already in the market may not find it optimal to set price low enough to deter all entry; moreover, those firms may misjudge the entry advantages of a particular firm and, therefore, the price necessary to deter its entry. 41/

3. Enforcement Standards. Because of the close relationship between perceived potential competition and actual potential competition, the Department will evaluate mergers that raise either type of potential competition concern under a single structural analysis analogous to that applied to horizontal mergers. The Department first will consider a set of objective factors designed to identify cases in which harmful effects are plausible. In such cases, the Department then will conduct a more focused inquiry to determine whether the likelihood and magnitude of the possible harm justify a challenge to the merger. In this context, the Department will consider any specific evidence presented by the merging parties to show that the inferences of competitive harm drawn from the objective factors are unreliable.

The factors that the Department will consider are as follows:

41/ When collusion is only tacit, the problem of arriving at and enforcing the correct limit price is likely to be particularly difficult.

a) Market Concentration. Barriers to entry are unlikely to affect market performance if the structure of the market is otherwise not conducive to monopolization or collusion. Adverse competitive effects are likely only if overall concentration, or the largest firm's market share, is high. The Department is unlikely to challenge a potential competition merger unless overall concentration of the acquired firm's market is above 1800 HHI (a somewhat lower concentration will suffice if one or more of the factors discussed in Section III(C) indicate that effective collusion in the market is particularly likely). Other things being equal, the Department is increasingly likely to challenge a merger as this threshold is exceeded.

b) Conditions of Entry Generally. If entry to the market is generally easy, the fact that entry is marginally easier for one or more firms is unlikely to affect the behavior of the firms in the market. The Department is unlikely to challenge a potential competition merger when new entry into the acquired firm's market can be accomplished by firms without any specific entry advantages under the conditions stated in Section III(B). Other things being equal, the Department is increasingly likely to challenge a merger as the difficulty of entry increases above that threshold.

c) The Acquiring Firm's Entry Advantage. If more than a few firms have the same or a comparable advantage in entering the acquired firm's market, the elimination of one firm is unlikely to have any adverse competitive effect. The other similarly situated firm(s) would continue to exert a present restraining influence, or, if entry would be profitable, would recognize the opportunity and enter. The Department is unlikely to challenge a potential competition merger if the entry advantage ascribed to the acquiring firm (or another advantage of comparable importance) is also possessed by three or more other firms. Other things being equal, the Department is increasingly likely to challenge a merger as the number of other similarly situated firms decreases below three and as the extent of the entry advantage over non-advantaged firms increases.

If the evidence of likely actual entry by the acquiring firm is particularly strong, 42/ however, the Department may challenge a potential competition merger, notwithstanding the presence of three or more firms that are objectively similarly situated. In such cases, the Department will determine the likely scale of entry, using either the firm's own documents or the minimum efficient scale in the industry. The Department will then evaluate the merger much as it would a horizontal merger between a firm the size of the likely scale of entry and the acquired firm.

42/ For example, the firm already may have moved beyond the stage of consideration and have made significant investments demonstrating an actual decision to enter.

d) The Market Share of the Acquired Firm. Entry through the acquisition of a relatively small firm in the market may have a competitive effect comparable to new entry. Small firms frequently play peripheral roles in collusive interactions, and the particular advantages of the acquiring firm may convert a fringe firm into a significant factor in the market. 43/ The Department is unlikely to challenge a potential competition merger when the acquired firm has a market share of five percent or less. Other things being equal, the Department is increasingly likely to challenge a merger as the market share of the acquired firm increases above that threshold. The Department is likely to challenge any merger satisfying the other conditions in which the acquired firm has a market share of 20 percent or more.

B. Competitive Problems from Vertical Mergers

1. Barriers to Entry from Vertical Mergers

In certain circumstances, the vertical integration resulting from vertical mergers could create competitively objectionable barriers to entry. Stated generally, three conditions are necessary (but not sufficient) for this problem to exist. First, the degree of vertical integration between

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43/ Although a similar effect is possible with the acquisition of larger firms, there is an increased danger that the acquiring firm will choose to acquiesce in monopolization or collusion because of the enhanced profits that would result from its own disappearance from the edge of the market.

the two markets must be so extensive that entrants to one market (the "primary market") also would have to enter the other market (the "secondary market") 44/ simultaneously. Second, the requirement of entry at the secondary level must make entry at the primary level significantly more difficult and less likely to occur. Finally, the structure and other characteristics of the primary market must be otherwise so conducive to non-competitive performance that the increased difficulty of entry is likely to affect its performance. The following standards state the criteria by which the Department will determine whether these conditions are satisfied.

a. Need for Two-Level Entry. If there is sufficient unintegrated capacity 45/ in the secondary market, new

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44/ This competitive problem could result from either upstream or downstream integration, and could affect competition in either the upstream market or the downstream market. In the text, the term "primary market" refers to the market in which the competitive concerns are being considered, and the term "secondary market" refers to the adjacent market.

45/ Ownership integration does not necessarily mandate two-level entry by new entrants to the primary market. Such entry is most likely to be necessary where the primary and secondary markets are completely integrated by ownership and each firm in the primary market uses all of the capacity of its associated firm in the secondary market. In many cases of ownership integration, however, the functional fit between vertically integrated firms is not perfect, and an outside market exists for the sales (purchases) of the firms in the secondary market. If that market is sufficiently large and diverse, new entrants to the primary market may be able to participate without simultaneous entry to the secondary market. In considering the adequacy of this alternative, the Department will consider the likelihood of predatory price or supply "squeezes" by the integrated firms against their unintegrated rivals.

entrants to the primary market would not have to enter both markets simultaneously. The Department is unlikely to challenge a merger on this ground where post-merger sales (purchases) by unintegrated firms in the secondary market would be sufficient to service two minimum-efficient-scale plants in the primary market. When the other conditions are satisfied, the Department is increasingly likely to challenge a merger as the unintegrated capacity declines below this level.

b. Increased Difficulty of Simultaneous Entry to Both Markets. The relevant question is whether the need for simultaneous entry to the secondary market gives rise to a substantial incremental difficulty as compared to entry into the primary market alone. If entry at the secondary level is easy in absolute terms, the requirement of simultaneous entry to that market is unlikely adversely to affect entry to the primary market. Whatever the difficulties of entry into the primary market may be, the Department is unlikely to challenge a merger on this ground if new entry into the secondary market can be accomplished under the conditions stated in Section III(B). 46/ When entry is not possible under those conditions, the Department is increasingly concerned about vertical mergers as the difficulty of entering the secondary market increases.

46/ Entry into the secondary market may be greatly facilitated in that an assured supplier (customer) is provided by the primary market entry.

The Department, however, will invoke this theory only where the need for secondary market entry significantly increases the costs (which may take the form of risks) of primary market entry.

i) Increased Cost of Capital as a Barrier to Entry. More capital is necessary to enter two markets than to enter one. Standing alone, however, this additional capital requirement does not constitute a barrier to entry to the primary market. If the necessary funds were available at a cost commensurate with the level of risk in the secondary market, there would be no adverse effect. In some cases, however, lenders may doubt that would-be entrants to the primary market have the necessary skills and knowledge to succeed in the secondary market and, therefore, in the primary market. In order to compensate for this risk of failure, lenders might charge a higher rate for the necessary capital. This problem becomes increasingly significant as a higher percentage of the capital assets in the secondary market are long-lived and specialized to that market and, therefore, difficult to recover in the event of failure. In evaluating the likelihood of increased barriers to entry resulting from increased cost of capital, therefore, the Department will consider both the degree of similarity in the essential skills in the primary and secondary markets and the degree of specialization of the capital assets in the secondary market.

ii) Economies of Scale as a Barrier to Entry. Economies of scale in the secondary market may constitute an additional barrier to entry to the primary market in some situations requiring two-level entry. The problem could arise if the capacities of minimum-efficient-scale plants in the primary and secondary markets differ significantly. For example, if the capacity of a minimum-efficient-scale plant in the secondary market were significantly greater than the needs of a minimum-efficient-scale plant in the primary market, entrants would have to choose between inefficient operation at the secondary level (because of operating an efficient plant at an inefficient output or because of operating an inefficiently small plant) or a larger than necessary scale at the primary level. Either of these effects could cause a significant increase in the operating costs of the entering firm. 47/

c. Structure and Performance of the Primary Market. Barriers to entry are unlikely to affect performance if the structure of the primary market is otherwise not conducive to monopolization or collusion. 48/ The Department is unlikely

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47/ It is important to note, however, that this problem would not exist if a significant outside market exists at the secondary level. In that case, entrants could enter with the appropriately scaled plants at both levels, and sell or buy in the market as necessary.

48/ For example, a market with 100 firms of equal size would perform competitively despite a significant increase in entry barriers.

to challenge a merger on this ground unless overall concentration of the primary market is above 1800 HHI (a somewhat lower concentration will suffice if one or more of the factors discussed in Section III(C) indicate that effective collusion is particularly likely). Above that threshold, the Department is increasingly likely to challenge a merger that meets the other criteria set forth above as the concentration increases. 49/

2. Facilitating Collusion Through Vertical Mergers.

a. Vertical Integration to the Retail Level. A high level of vertical integration by upstream firms into the associated retail market may facilitate collusion in the upstream market by making it easier to monitor price. Retail prices are generally more visible than prices in upstream markets, and vertical mergers may increase the level of vertical integration to the point at which the monitoring effect becomes significant. Adverse competitive consequences

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49/ Even if all the conditions above are satisfied, the Department may not challenge a particular merger. The likelihood of significant competitive harm is lower than it is for horizontal mergers identified as competitively objectionable under the standards in Section III, and the extensive pattern of use integration, which is a necessary condition to the competitive problem under discussion, may constitute evidence that substantial economies are afforded by vertical integration. When such economies are present, it might be economically perverse and inequitable to the remaining independent firms to deny them the ability to integrate through merger.

are unlikely unless the upstream market is generally conducive to collusion and a large percentage of the products produced there are sold through vertically integrated retail outlets.

The Department is unlikely to challenge a merger on this ground unless i) overall concentration of the upstream market is above 1800 HHI (a somewhat lower concentration will suffice if one or more of the factors discussed in Section III(C) above indicate that effective collusion is particularly likely), and ii) a large percentage of the upstream product would be sold through vertically-integrated retail outlets after the merger. Where the stated thresholds are met or exceeded, the Department's decision whether to challenge a merger on this ground will depend upon an individual evaluation of its likely competitive effect. 50/

b. Elimination of a Disruptive Buyer. The elimination by vertical merger of a particularly disruptive buyer in a downstream market may facilitate collusion in the upstream market. If upstream firms view sales to a particular buyer as sufficiently important, they may deviate from the terms of a collusive agreement in an effort to secure that business, thereby disrupting the operation of the agreement. The merger of such a buyer with an upstream firm may eliminate that rivalry, making it easier for the upstream firms to collude

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50/ See note 49, above.

effectively. Adverse competitive consequences are unlikely unless the upstream market is generally conducive to collusion and the disruptive firm is significantly more attractive to sellers than the other firms in its market.

The Department is unlikely to challenge a merger on this ground unless i) overall concentration of the upstream market is 1800 HHI or above (a somewhat lower concentration will suffice if one or more of the factors discussed in III(C) above indicate that effective collusion is particularly likely), and ii) the allegedly disruptive firm differs substantially in volume of purchases or other relevant characteristics from the other firms in its market. Where the stated thresholds are met or exceeded, the Department's decision whether to challenge a merger on this ground will depend upon an individual evaluation of its likely competitive effect.

3. Evasion of Rate Regulation

Non-horizontal mergers may be used by monopoly public utilities subject to rate regulation as a tool for circumventing that regulation. The clearest example is the acquisition by a regulated utility of a supplier of its fixed or variable inputs. After the merger, the utility would be selling to itself and might be able arbitrarily to inflate the prices of internal transactions. Regulators may have great difficulty in policing these practices, particularly if there is no independent market for the product (or service) purchased from the affiliate. 51/ As a result, inflated prices could be passed along to consumers as "legitimate" costs. In extreme cases, the regulated firm may effectively preempt the adjacent market, perhaps for the purpose of suppressing observable market transactions, and may distort resource allocation in that adjacent market as well as in the regulated market. In such cases, however, the Department recognizes that genuine economies of integration may be involved. The Department will consider challenging mergers that create substantial opportunities for such abuses. 52/

V. DEFENSES

A. Efficiencies

In the overwhelming majority of cases, the Guidelines will allow firms to achieve available efficiencies through mergers without interference from the Department. Except in extraordinary cases, the Department will not consider a claim of specific efficiencies as a mitigating factor for a merger

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51/ A less severe, but nevertheless serious, problem can arise when a regulated utility acquires a firm that is not vertically related. The use of common facilities and managers may create an insoluble cost allocation problem and provide the opportunity to charge utility customers for non-utility costs, consequently distorting resource allocation in the adjacent as well as the regulated market.

52/ Where a regulatory agency has the responsibility for approving such mergers, the Department will express its concerns to that agency in its role as competition advocate.

that would otherwise be challenged. 53/ Plausible efficiencies are far easier to allege than to prove. Moreover, even if the existence of efficiencies were clear, their magnitudes would be extremely difficult to determine.

B. Failing Firm

The "failing firm defense" is a long-established, but ambiguous, 54/ doctrine under which an anticompetitive merger may be allowed because one of the merging firms is "failing." Because the defense can immunize significantly anticompetitive mergers, the Department will construe its elements strictly.

53/ At a minimum, the Department will require clear and convincing evidence that the merger will produce substantial cost savings resulting from the realization of scale economies, integration of production facilities, or multi-plant operations which are already enjoyed by one or more firms in the industry and that equivalent results could not be achieved within a comparable period of time through internal expansion or through a merger that threatened less competitive harm. In any event, the Department will consider such efficiencies only in resolving otherwise close cases.

54/ Although its original basis is open to question, the defense is sometimes explained as a balancing of competitive and non-competitive concerns. Under that view, when the elements of the defense are satisfied, there is a conclusive presumption that the anticompetitive dangers associated with the merger are outweighed by the income losses to creditors, stockholders, and communities associated with the failure of the firm. As a general matter, the Department views the incorporation of non-competitive concerns into antitrust analysis as inconsistent with the mandate contained in the antitrust laws. To the extent that the financial health of the firm is relevant to the competitive analysis, the Department, of course, will consider it in that context.

The Department is unlikely to challenge an anticompetitive merger in which one of the merging firms is allegedly failing when: 1) the allegedly failing firm probably would be unable to meet its financial obligations in the near future, and 2) it probably would not be able to reorganize successfully under Chapter 11 of the Bankruptcy Act, 55/ and 3) it has made unsuccessful good faith efforts to elicit reasonable alternative offers of acquisition of the failing firm 56/ that would both keep it in the market and pose a less severe danger to competition than does the proposed merger. Although these standards are more difficult to apply when the allegedly failing firm is an unincorporated part of a larger parent firm, the Department will recognize the defense in appropriate cases of that type. 57/

55/ 11 U.S.C.A. §§ 1101 *et seq.* (1979).

56/ The fact that an offer is less than the proposed transaction does not make it unreasonable.

57/ The Department is unlikely to challenge an otherwise anticompetitive merger in which one of the merging firms is a financially healthy subdivision of an allegedly failing parent firm when: 1) the parent firm satisfies the above conditions, and 2) the competitive harm from the disappearance of the parent firm from its market would substantially outweigh the competitive harm threatened by the merger, 3) the proposed transaction probably would enable the parent firm to avoid bankruptcy or to reorganize successfully, 4) the third condition stated in the text also has been satisfied with respect to the healthy subdivision, and 5) the merging firm is not capable of independent existence as a business entity. Where the merging firm is capable of independent existence, the Division may insist that the parent company attempt to transfer common stock in it to the parent company's debtors.

Senator RUDMAN. Thank you very much, Mr. Baxter.

We are going to have about a 10- or 15-minute rule here this morning, and I will lead off with some questions. I would like to get right down to the specifics. Those of us who have been active in the antitrust area and who have been following what you have been doing, I think, can probably dispense with some of the theories that have been applied to produce these guidelines. I want to get down to some specific questions and get you on the record this morning so we clearly understand what your position is. I think this is the first opportunity to do that, at least before the Senate.

I want to look, to start out with, at some specific examples taken from your department of how you are now using the so-called Herfindahl index, which is the sum of the squares of the market share of the firms within the defined market. Your guidelines, of course, now define that index at a level at which you will look at these mergers.

The first case I want to look at is *U.S.* v. *Newell Co.* In that case, it is alleged by you that Stanley Works 'acquisition violated section 7 of the Clayton Act, and the acquisition increased the Herfindahl index under the way it is computed from 2,300 to about 2,600, and you said that they ought to be required to divest. I don't have any problem with that. I think that was a proper application.

I want to move to another case, and that is the *U.S.* v. *Stroh Brewery* case which I want to ask you about. In that case, filed in April 1982, the Department called the proposed merger of Stroh and Schlitz against the guidelines that you had set forth, essentially in violation of the law. Stroh is the fifth largest brewer in the market and controls about 6.9 percent of the sales in 1980; Schlitz, the third, about 13.4.

The combination would have increased the Herfindahl by 186 points by your documents, from 2,345 to 2,531, which is well up in the area of concern as expressed in your own guidelines.

However, in the consent decree, rather than do what you did in the *Stanley* case, the *Newell* case, what you essentially did was to require that Stroh divest itself of only one of the five breweries owned by Schlitz.

Can you explain to the committee this morning your actions in this case as compared to the *Newell* case? I ask the question, Mr. Baxter, because it seems to me, looking at your own numbers, that even with the divestiture of one of the Schlitz plants, the Herfindahl would have a tremendous increase, and there would be a final result considerably above the level which you have stated is one that raises a warning sign. Could you first discuss that matter?

Mr. BAXTER. Yes, surely.

The *Newell* case to which you refer involved drapery hardware. The market for drapery hardware is a national market. It does not make any difference where it is manufactured in the United States; it is shipped and sold throughout the United States. The cost of shipping drapery hardware is a very, very small fraction of its final selling price and is no barrier to its transportation throughout the country. It does not spoil; it does not lose its flavor; it works just as well when it gets to Los Angeles in a boxcar as it did when it left New England.

So the only relevant market and the only market in which competition could be affected in a case like *Newell* is the national market. The concentration in those national markets was quite high. I am not able to reproduce the numbers off the top of my head, but the numbers you recite to me sound in accord with my recollection.

Now, in a case like that, there is no cure to the problem except to block the merger. That merger already having occurred, we had to undo it, and we called for divestiture, as you indicate.

In the *Stroh-Schlitz* case, the situation was somewhat different. There is a national market in beer, or at least a series of large regional markets that overlap one another, so that I would have no reluctance to talk in terms of the national beer market and to pay serious attention to the level of concentration in a national beer market, as we have done in a number of cases and did in *Schlitz-Stroh*.

Now, in *Schlitz-Stroh*, the concentration at the national level was not very high. The end point Herfindahl index was high enough to be of concern, but the amount by which the index was changed by the merger, to the best of my present recollection, was 79 or 72; in any event, it was substantially below the 100 threshold that is articulated in the merger guidelines.

Accordingly, we did not object to the Schlitz-Stroh merger on the basis of what it did to the concentration in the national market. There was, however, a regional market problem in Schlitz-Stroh.

Senator RUDMAN. Well, let me just interrupt you for one moment, just so you can leave from the proper juncture in terms of your position. The understanding that we have is that the total seller concentration would have increased by 186 points.

Mr. BAXTER. In the national market?

Senator RUDMAN. Well, that is my understanding. If that is incorrect, then you can let us know about that. That is what we have here.

Mr. BAXTER. I am sure that is incorrect.

Senator RUDMAN. It is incorrect?

Mr. BAXTER. It is incorrect.

Senator RUDMAN. All right.

Mr. BAXTER. The only market in which there was an increase in excess of guidelines was in the southeastern portion of the United States. That in some ways is a unique region precisely because it is in a corner of the country. A region of similar geographic size in the middle of the United States probably would have been a region into which brewers, wherever they were located in the United States, could ship. But when one gets a regional market located in a corner of the United States, as we had in Schlitz-Stroh, there will be distant brewers who are unable economically to ship into that area. That was the case in the Southeast. The number of brewers who were marketing in the Southeast was smaller than the national number, and as a result concentration was higher. Both Schlitz and Stroh were significant factors in the southeast market, and so the merger had a more significant concentrating effect and, accordingly, resulted in a larger change in the index number in the Southeastern United States than it did in the national market.

Now, in response to that localized problem, we said, that the merger on a national basis was not troublesome under the guidelines and that we did not want to interfere with the merger if the problem down in the Southeastern part of the United States could be cured. And so we worked out with them an arrangement under which they would spin off one of two very large and relatively new and efficient breweries in the Southeastern United States to some other, smaller company. This action would have the effect of deconcentrating that Southeastern market. It is exactly the same kind of a remedy that we would have requested if we had gone into court against Stroh-Schlitz seeking to enjoin the full merger. In this instance we had a regional problem; we would have asked for a regional solution. We would have asked the court to order the parties to do precisely what we negotiated with them here. However, such court action was made unnecessary when they agreed to spin off one of those breweries.

Senator RUDMAN. All right. I think I understand your answer, and we can have discussion about that, but we wanted to get you on the record on that for a number of reasons.

Mr. BAXTER. Surely.

Senator RUDMAN. Essentially, your answer is that you look at the national application of Herfindahl, but in a number of cases, because of products, you look at regional impact.

Mr. BAXTER. That is right.

Senator RUDMAN. And that is your reason in this particular case.

Mr. BAXTER. Section 7 of the Clayton Act speaks to a lessening of competition in any line of commerce, that is, in any section of the country. The Southeast, in that instance, was a "section of the country."

Senator RUDMAN. We will move on from your merger guidelines because I know others have many questions on that. The second question I want to ask you is if you agree with me that the present status of the law involving resale price maintenance is that it is a per se violation of section 1 of the Sherman Act.

Mr. BAXTER. Unfortunately, there is no doubt about that.

Senator RUDMAN. You agree with that.

Now, GTE and Sylvania, some people cite that case as an exception to that. You don't cite that as an exception to that, do you?

Mr. BAXTER. I think it was tenable to cite it as an exception until the Supreme Court's decision in the *Maricopa* case.

Senator RUDMAN. All right. Then I think we understand that. I just want to get those two points.

Now, if that is the case, could you please explain to me, understanding something about prosecutorial discretion, that with resale price maintenance as the law of the land, not only by the Congress but as interpreted by the Supreme Court, how can you take the attitude that you have taken recently in many public statements, essentially saying that it is economically not justified, which you may be right about—we are not arguing that—but how can you, with any amount of prosecutorial discretion, decide to essentially put those aside and say, "I don't intend to move on those cases because I essentially don't think they have the economic effect that the courts think and the Congress thinks." I mean, how do you take that position, Mr. Baxter?

Mr. **Baxter**. Well, in the first place, Congress has never indicated in any statutory language that all vertical price fixing, without reference to its economic effects or its commerical context, is unlawful.

Senator **Rudman**. Well, let me just stop you right there. Are you aware of that fact that in 1975 Congress passed legislation—it is known as Public Law 94-15—and it repealed the Federal antitrust exemptions permitting States to enact fair trade laws? As you know, those fair trade laws permitted manufacturers to require retailers to resell at a price set by the manufacturers.

In the Judiciary Committee report it is stated, "These laws are in fact legalized price-fixing," and it went on at some length. Now, it seems to me that that just has to be looked at.

Mr. **Baxter**. Well, I have no doubt about. They were legalized price fixing. Those laws were serious mistakes. I urged one class after another for 20 years at Stanford to understand the reasons why the fair trade laws were perverse and mistaken and were properly repealed, but none of that has anything to do with the topic that you are now raising.

The fair trade laws were per se legalization in a wide variety of commercial contexts of resale price maintenance. They legalized resale price maintenance in a wide variety of contexts where resale price maintenance was harmful and where we would bring cases against it today if we could possibly find it occurring. Indeed, because it is widely but mistakenly viewed to be the position of the Department that we will not bring any cases, I have reportedly exhorted my staff to try to find a sensible resale price maintenance case to bring, and if we can find one, we will bring one.

Senator **Rudman**. So you are telling us this morning that what we have understood to be the position of your Department, we have had a misunderstanding——

Mr. **Baxter**. Right.

Senator **Rudman** [continuing]. That you intend to enforce the law in this area.

Mr. **Baxter**. Yes. Now, I don't want you to misunderstand what I am saying. I am not saying that resale price maintenance is unlawful in every context in which it appears. Indeed, quite the contrary; it should be the law that resale price maintenance is illegal only where there is showing of anticompetitive effect, although the Supreme Court's language has been very, very sweeping, and unfortunately so, in the direction of conclusively presuming an anticompetitive effect even in the absence of any proof of such effect.

Senator **Nunn**. Wait a minute. I am confused already. [Laughter.]

Mr. **Baxter**. I am sorry.

Senator **Nunn**. I followed you pretty well up to there, but you just said that you didn't want us to misunderstand that something should be the law. Now, we are talking about what is the law. I think Senator Rudman is talking about what is the law. If we could stick to that for the purposes of this——

Mr. **Baxter**. No question about what the law is. The Supreme Court——

Senator **Nunn**. It is illegal per se.

Mr. BAXTER. It is illegal per se, without reference to the context or anything else. No question.

Senator NUNN. But is the Justice Department's position that it is illegal per se?

Mr. BAXTER. If your question is what the law is, there is no question about it. It is illegal per se.

Senator NUNN. Well, let's say, what is the Justice Department's position? Are you enforcing on the basis of the law? That is, are you enforcing on the basis of that being illegal per se?

Mr. BAXTER. Oh, yes, I would say we would. I can think of various horizontal minimum price-fixing agreements that one comes across from time to time where you ask the question, is it a worthwhile devotion of departmental resources to bring this case? The answer may be no if the activity is small, if it is localized, or if there is no effective remedy. One does not have to disagree with the legal proposition that a sphere of activity is illegal per se in order to reach the conclusion that certain instances of that conduct do not warrant the devotion of enforcement resources to them.

There is no activity which I find more reprehensible or think more damaging to the economy than cartel-type behavior. Even so, within the last year, I came across an instance of cartel-type behavior in a portion of the United States in a very small industry among relatively unsophisticated people who bore relationships to one another where I could not imagine how we could really effectively stop the activity in question and I decided that it was not an instance worth the enforcement effort.

Now, that I regard as a judgment that is properly committed to my discretion, and there will be instances of vertical price maintenance within the scope of the Supreme Court's language where I will reach a similar conclusion.

Senator RUDMAN. I have one question and my 15 minutes will be up, and I just want to quickly go into a tying area. We may have another round, Mr. Baxter, because there are a number of questions I want to ask.

Mr. BAXTER. Sure.

Senator RUDMAN. It is our understanding in the *Mercedes* case that it was your position that the alleged tying arrangement which essentially—Mercedes allegedly told distributors that they must purchase parts, and so forth, from Mercedes rather than competitive products; that you, for reasons you can tell me in your answer—tell me if I am factually correct—dropped that case, although the case is still being pursued in the State of Maryland by a private party. Is that correct, that the case was dropped by Justice?

Mr. BAXTER. That is substantially correct.

Senator RUDMAN. And your reason that you gave is you did not think it would have an adverse effect competitively on consumers. I think that was essentially the answer.

Mr. BAXTER. I gave several explanations for that action, but that certainly was one of them.

Senator RUDMAN. Let me ask you this question, Mr. Baxter. If you had allegations that were proven—and I am going to say this is a hypothetical; I have no such allegations—but if you had an allegation that Chevrolet or Ford had some conspiratorial tying arrangements through its distributors and dealers to purchase only Ford/Chevrolet parts, would you take a different attitude?

Mr. **Baxter**. I would not expect that practice, in the long run, to be detrimental to consumers. It certainly again is within an area of activity that the courts have described as per se illegal, However, that characterization is one of the stranger uses of the term "per se," because the Supreme Court in tying cases, in fact, requires that a number of different, quite complex factors be proved including its effects which is inconsistent with our usual notion of what "per se" means. After you get through proving each of a number of fairly complex elements, the Supreme Court then says, in effect, "Having proved all those things, we can now see that the practice is unlawful per se", so that "per se" in that context winds up being more an epithet that is used at the end of the case than something that really describes the proof element.

Senator **Rudman**. Well, did I understand your answer correctly that you would not see that kind of an arrangement as being anticompetitive? Did I understand you correctly?

Mr. **Baxter**. It depends whether we are talking about a legal proposition or an economic proposition. As an economic proposition, that is unlikely to be harmful to consumers.

Senator **Rudman**. Let's see if I understand you. Maybe we are not talking the same language. My hypothetical said that a Ford dealer essentially had to be tied to the Ford distributor, who was tied to their parts, so if the fuel pump in my Mustang broke down, and I went in to have it fixed——

Mr. **Baxter**. Went into an authorized Ford dealer.

Senator **Rudman** [continuing]. A Ford dealer to have it fixed, and because I am under warranty of all kinds for the first 40,000 miles, I tend to take the car to that dealer, and most Americans do for that reason, then I had no choice but to be charged for a fuel pump manufactured by the Ford Motor Co.

Mr. **Baxter**. That is correct.

Senator **Rudman**. Well, wouldn't it be better for me as a consumer if that Ford Motor dealer had the option of buying a fuel pump from an independent manufacturer that might, for competitive reasons, sell it for less?

Mr. **Baxter**. Well, if you bought your car under one regime of law, if you bought it when Ford understood that it would not be able to impose the tying requirement, and the rule then changed in some way, that might be so. But if we are talking about a society in which there is one set of rules and people know what they are, and the question is, Would consumers be better off with one set of rules running through time or would they be better off with another set of rules running through time? There is no reason to believe that consumers would be better off under the circumstances you are suggesting than under the other.

Senator **Rudman**. Well, I must respectfully disagree, and I am going to turn it over to Senator Nunn. Senator Nunn?

Senator **Nunn**. Thank you, Mr. Chairman.

Mr. Baxter, a Washington Post article, a recent one, had the following opening paragraph, and I will read that to you and get your comments on it, and I quote:

A growing number of manufacturers are dictating the retail prices that stores can charge for their products. Although this price-setting violates Federal law, according to Assistant Attorney General William F. Baxter, it has his blessings in most cases.

I am quoting directly from the first paragraph of an article of August 16, 1982, Washington Post. Would you comment on that paragraph?

Mr. **Baxter**. Yes. I have no idea where they are getting their factual information about a growing number of manufacturers. They make no reference to any particular manufacturer, so that if they have any factual information on which that paragraph is based, they don't reveal what it is.

I don't know what they mean exactly when they say it has my blessing. I take it they are referring to statements which I have made at various times, and again here this morning, that in a variety of commercial contexts, although not in others, resale price maintenance is desirable from the standpoint of consumers and would be described by economists who have studied such situations as being competitive rather than anticompetitive.

Senator **Nunn**. All right. On that point, you said a few minutes ago in answer to Senator Rudman's question, as I understand it, that you acknowledge the Supreme Court has said those types of arrangements are illegal per se.

Mr. **Baxter**. Indeed, the Washington Post paragraph says that I have said that.

Senator **Nunn**. All right. You just got through saying a minute ago that those practices are desirable in some cases.

Mr. **Baxter**. Yes, they are desirable.

Senator **Nunn**. Now, that is your opinion, right?

Mr. **Baxter**. Yes.

Senator **Nunn**. That is not the law, though.

Mr. **Baxter**. No.

Senator **Nunn**. There is a difference between your opinion and the law.

Mr. **Baxter**. No question about that.

Senator **Nunn**. All right. But now, as the chief enforcement officer of the antitrust laws, if this article is correct and if these practices are occurring, what is your enforcement position? Are you going to enforce the law as it now exists?

Mr. **Baxter**. We are going to use our resources to enforce the antitrust laws starting with those instances that do the largest amounts of harm to consumers and coming on down as long as the resources last.

Senator **Nunn**. That sounds as if your priorities are based on your opinion rather than on a broad enforcement of the law; that you are going to take those areas that you don't agree with of the law and you are going to put them on the bottom of your priority list. Is that what you are telling us?

Mr. **Baxter**. I am telling you that I will devote the resources of the Department in accordance with my best understanding of the levels of harm that are done to consumers.

Senator **Nunn**. Are you going to ask for more resources if it becomes apparent that you cannot carry out the law of the land?

Mr. **Baxter**. Yes, indeed. I had meant to bring that up this morning, as a matter of fact. [Laughter.]

I came into office with a budget that involved a 40-person reduction this year, and that was submitted to the Congress. The House Appropriations Committee reduced the budget not only by the 40 positions which I indicated I thought perhaps we could get along without and still have an effective enforcement program, but by another 43 positions and by another $2.8 million, I believe, although I may be wrong about those numbers. I did want to urge this committee to restore those additional funds and positions because I don't think it will be possible to do an effective job of law enforcement without them.

Senator RUDMAN. If Senator Nunn would yield, this is a joint hearing of the Small Business Committee and an Appropriations Subcommittee, Mr. Baxter, and you are incorrect.

Mr. BAXTER. Am I?

Senator RUDMAN. And I think Senator Nunn ought to know what the facts are here because you are confusing 1983 with 1982. Let me give you the numbers, for reasons that you will soon see.

In 1982, the appropriation was $44 million. That was about a million dollars below the 1981 funding level, but you were still able to absorb all of your pay costs, and you had $2.8 million left in excess of everything you used.

The Justice Department advised our subcommittee, of whom the chief staff person is with us this morning, and has just advised me that we could use that $2.8 million to offset other expenses in the Justice Department. My position is, Senator Nunn, that they have not used their appropriation, so I don't know what this talk is about resources this morning, Mr. Baxter.

Mr. BAXTER. No, I am talking about the request for 1983, not the pattern during 1982.

Senator RUDMAN. Oh. Your answer to Senator Nunn indicated that you might have some limitation of resources. That was the clear inference. My position, being on that subcommittee, Mr. Baxter, is, respectfully, that you had about $3 million left, and let me tell you, when I was attorney general of New Hampshire, that would go a long way to file some antitrust cases.

Mr. BAXTER. Well, we did indeed. That is what happened in 1982. Because, at the end of the year, funds did pile up, we went into the year with an expectation of very, very heavy expenses in both the IBM and AT&T litigation which were still in full swing. The budget was cut very substantially from the prior appropriations level, and we adjusted to it in a variety of cost-saving ways. Within the next 3 or 4 months, I had completed my review of the IBM case and decided to dismiss it, and we were able to negotiate a very favorable settlement of the AT&T case, so that indeed we did wind up the year with an excess of funds.

We had cut travel to unsustainable levels. We had cut particularly the level of computer support for our litigation.

Senator NUNN. Well, are you saying at this point in time you do or do not have enough resources?

Mr. BAXTER. At this point in time, I am concerned about the level of appropriation for fiscal 1983.

Senator NUNN. Do you agree with the administration's budget submission?

Mr. BAXTER. Yes, I do.

Senator NUNN. So if you get the administration's submission, you will have enough resources to enforce the law of the land?

Mr. BAXTER. Yes; of course. That does not mean that we would file every conceivable case that comes along, but we will have enough funds to do a thorough and responsible job of enforcing the antitrust laws.

Senator NUNN. Including those areas of vertical price-setting that you say are violations per se? You will be able to enforce those areas, too?

Mr. BAXTER. I have no idea in advance how many cases will come along.

Senator NUNN. But you think you will be able to generally enforce that part of the law with the resources requested by this administration for fiscal 1983?

Mr. BAXTER. I think we will be able to enforce the great majority of cases where damage to consumers is likely to occur.

Senator NUNN. Well, it sounds to me as if you are right back to your position that you have a violation per se as declared by the Supreme Court, and you disagree with that on a policy basis. You think that decision is wrong. It sounds to me as if you are still clearly saying that even if you get the resources you requested in 1983, that you are going to relegate those cases to a very low priority.

Mr. BAXTER. I am.

Senator NUNN. And in all likelihood there will not be cases brought in that area.

Mr. BAXTER. I will relegate them to a low priority.

Senator NUNN. That really means that the law of the land is not being enforced by the antitrust division of the Department of Justice.

Mr. BAXTER. No; it does not.

Senator NUNN. Well, I think if the FBI were to announce that kidnaping was no longer of great harm to society and that they were going to put kidnaping at the bottom of their enforcement list, we would have in effect a change in the law by the FBI.

Senator RUDMAN. I think we might also hear from our constituents. [Laughter.]

Senator NUNN. I think we are going to hear from them on some of the statements that have been made today by Mr. Baxter, too, because you can change the law simply by not enforcing it, can you not?

Mr. BAXTER. Not in any very significant ways, but certainly one can shift priorities, yes.

Senator NUNN. Well, particularly, you have changed the law if you have announced those priorities very clearly so that everyone engaged in certain practices that are illegal per se now knows that that is such a low priority that you will not enforce it.

Mr. BAXTER. No; there is another very important——

Senator NUNN. It seems to me, Mr. Baxter, you have changed the law of the land.

Mr. BAXTER. No; that is not correct.

Senator NUNN. In practical effect.

Mr. BAXTER. No; that is not correct. There is a very important consideration which you are leaving out of account. Certainly one of the things that I would take into account, and which I think it quite appropriate to take into account in deciding which cases to bring, is the adequacy of private enforcement. There are portions of the antitrust laws that are very effectively enforced by private suits and portions of the antitrust laws which are not effectively enforced by private suits.

The portions of the law that you happen to be focusing on this morning are portions that are very effectively enforced privately. That fact represents an additional reason why, in comparison with some other areas in which enforcement resources are limited, the portions upon which you are focusing might properly be given a lower Government enforcement priority.

The phenomenon of private enforcement, particularly in those areas, is a very effective one, and the notion that the law is in any significant sense changed by our alteration of enforcement priorities is not correct.

Senator NUNN. I just have a few more questions on this round because I know we have a time problem and we have other important witnesses. In that same Post article, there is a quote in the next-to-last paragraph by Mr. Sanford Litvack, and I quote exactly: 'Sanford Litvack, who preceded Baxter in his post at the Justice Department, said 'it is fundamentally wrong,' for the Nation's chief antitrust official to not enforce the law because he doesn't like it." Do you agree or disagree with that quote attributed to Mr. Litvack?

Mr. BAXTER. Well, Mr. Litvack is in the same asymmetric position that I referred to a few moments ago. He thought there was nothing wrong whatsoever with pushing for applications of antitrust law that no one had ever contemplated before, but any movement in the opposite direction he sees in very different terms.

Senator NUNN. Well, that doesn't get to the question. The question is, he said it was fundamentally wrong for the Nation's chief antitrust officer to not enforce the law because he doesn't like it.

Mr. BAXTER. That begs the question.

Senator NUNN. Well, let me beg the question, then. Do you agree with that statement or do you disagree with it?

Mr. BAXTER. I think the statement is not coherent. It simply shifts in midstream.

Senator NUNN. In other words—well, let's forget Mr. Litvack for a moment.

Mr. BAXTER. All right.

Senator NUNN. Let me just ask you the question. Do you think it is fundamentally wrong for the Nation's chief antitrust officer not to enforce the law of the land?

Mr. BAXTER. Yes.

Senator NUNN. Thank you.

Senator RUDMAN. Thank you very much, Senator Nunn.

We are going to depart from our normal procedure here. Normally, other Members of the Senate, under Senator Weicker's rules, I learned, could sit in on the panel but not question, but because of Senator Metzenbaum's former chairmanship and his interest, in light of time, I would ask the Senator to maybe ask a couple of brief questions if he could, and then we will move to Senator Gorton.

Senator METZENBAUM. Senator Rudman, I very much appreciate your courtesy. Frankly, I have been enjoying the line of questioning by the members of the committee so much that I will just give up my time and sit here and enjoy the balance of this hearing. [Laughter.]

Senator RUDMAN. I think we have seen a very rare occurrence here. [Laughter.]

Senator NUNN. I think probably more appropriately two rare occurrences: First, the Senator enjoying other Senators, and, second, waiving time. [Laughter.]

Senator RUDMAN. Senator Gorton?

Senator GORTON. Mr. Chairman, if I may, I will precede my initial questioning with an opening statement because they are relevant to one another. .

Senator RUDMAN. Please proceed.

STATEMENT OF HON. SLADE GORTON, A U.S. SENATOR FROM THE STATE OF WASHINGTON

Senator GORTON. I fully share the concern expressed by the chairman of this committee, Senator Weicker, about the administration's enforcement of the Nation's antitrust laws. I also feel a sense of deja vu.

Mr. Baxter and other administration spokesmen have come to Capitol Hill on numerous previous occasions in order to discuss this subject with concerned Members of the Congress. It is the fact that we have been here so many times before that bothers me most.

On December 1 of last year I chaired a hearing of the Productivity and Competition Subcommittee of this committee on precisely the same subject as this morning's hearing. Mr. Baxter was a witness, and he heard a number of strong statements by Senators and representatives of the small business community, very much like those we will hear today. That was only one of a long series of similar hearings before a number of Senate and House committees dating back to early in the first session of the 97th Congress.

This process began when Mr. Baxter and other top administration antitrust officials began making public statements which indicated that they disagree with some of the laws on the books, or with a clear line of Supreme Court precedents interpreting them. Those responsible for enforcing the Federal antitrust laws seem to believe that some of those laws are excessive, inefficient, or unwarranted.

The reaction of the Congress to these public statements was swift and strong. Many Members, representing both parties and the entire political spectrum, have seriously questioned the wisdom of abandoning the traditional enforcement approach in areas such as mergers, vertical restraints, price discrimination, and predatory pricing.

Frankly, it bothers some of us to see such a sudden, significant departure from previous longstanding policies which were pursued by Republican and Democratic administrations alike. We are bothered because these changes seem to be based on the wholesale adoption of economic theories which are the subject of great dispute, at least in their practical application.

It concerns some of us to see the economic efficiency considerations underlying the antitrust laws emphasized to a point of ignoring entirely the important social and political considerations which clearly also motivated Congress in passing antitrust statutes. It especially bothers many of us on the Small Business Committee to see apparent abandonment of the congressional purpose to preserve small business for its own sake.

Small companies are the primary generators of new jobs. Dollar for dollar, they are much more innovative than large enterprises. They tend to be especially responsive to the needs of the surrounding communities. A vigorous small business community is obviously a most important element and asset for the economic recovery of this Nation.

The democratic principles of decentralization of economic and political power which helped move the Congress in passing the Sherman and Clayton Acts are being viewed today with a renewed sense of importance.

Philosophical disagreement is not the primary concern, however. Congress has been most upset by strong implications from administration spokesmen that they do not intend to ask the Congress to change laws with which they disagree but rather will attempt unilaterally to mold the laws to fit their philosophy through an announced policy of selective enforcement.

The public statements have sent a message to the business community that certain defined conduct, previously considered unlawful, will be tolerated by the administration at least in certain circumstances. Antitrust lawyers, business executives, and Wall Street financiers have stated that these signals have already been received. Business conduct is, in fact, being adjusted accordingly, especially in the merger and vertical restraint areas.

The most recent example of the transmittal of such signals is represented by the August 13 Washington Post interview with Mr. Baxter. He is quoted in that article as saying that although he recognizes that resale price maintenance is per se unlawful under existing law, he disagrees with that rule and he intends to enforce it only in most limited circumstances.

Although executive discretion in the allocation of limited resources for enforcement is certainly necessary, it is clearly improper for the administration to announce a tolerance policy for certain types of law violations and thus, in effect, to amend legislation by fiat. Despite continuous loud and strong complaints from the Congress, however, this practice continues.

I have a number of specific technical questions to submit for Mr. Baxter's written response. Today, however, I should like to concentrate on the one all-encompassing general question which I believe underlies this hearing: Does the administration intend to continue this practice, or will it instead finally present to the Congress its proposals for law reform and, in the meantime, vigorously enforce all of the existing laws?

Mr. **Baxter**. Senator Gorton, the Antitrust Division has no existing legislative program. It is my hope to have such a program next spring. I don't know at this time what it will consist of.

The primary difficulty I have with the way your question about our legislative program is posed is that the quarrels that we have are primarily with judicial interpretations and not with the statutes as they are written and appear on the books.

Section 7 of the Clayton Act, for example, states that a merger is unlawful when it may substantially lessen competition in any line of commerce in any section of the country. I think it is felicitous phrasing. I could not have put it better. I have absolutely no quarrel with what Congress has said.

What should I ask Congress, then, to do, to italicize the word "substantially"? It is very hard to come up with a legislative package where you have no quarrel with what the statutes say.

Section 1 of the Sherman Act, on which much of the vertical jurisprudence is based, talks about agreements in restraint of trade. Again, I find that very felicitous phrasing. Agreements which restrict output should be held unlawful. That is how one restrains trade, by restricting output. I am being absolutely faithful to the language of section 1.

The difficulty is that the judicial interpretations are not uniformly faithful. Our quarrel being largely with the courts rather than with Congress, we are going back to the courts, and we are asking them to read what Congress has said, to pay attention to it, and to get back to what those statutes say. An agreement is unlawful under section 1 of the Sherman Act only if it unreasonably restrains trade as you said in the great cases of 1911. Is there a plausible hypothesis on which this particular agreement can restrict output and thus unreasonably restrain trade? No, we say, there is not, and therefore it should not be swept up as illegal.

We are busily about the process of attempting to achieve law reform in one of the permissible places for us to achieve law reform; that is to say, in the process of interpretation by the courts. That is where the errors have been made, and that is where the remedy is most effectively sought.

Senator GORTON. Is it the basic thrust of what you are saying now that Congress was right and felicitous in the passage of each of these antitrust statutes and that the law is erroneous only to the extent that the courts have departed from what you consider to be the intent of Congress?

Mr. BAXTER. Yes.

Senator GORTON. So your quarrel is with the Supreme Court which you feel has misinterpreted the Sherman and Clayton Acts, among others?

Mr. BAXTER. Not the Supreme Court alone, but in part. There is nothing particularly new about that statement. I am sure that the Supreme Court would not be offended. The Supreme Court has many, many times, itself, concluded over the years that it has made errors. It decided the *Knight* case at the turn of the century and rapidly abandoned it, and it decided that the United States Steel merger was lawful and did not involve monopolization as demonstrated by the fact that they were having to——

Senator GORTON. Which recent Supreme Court decisions do you think are likely to be abandoned in the foreseeable future?

Mr. BAXTER. The Maricopa decision, for example.

Senator GORTON. Is that a statement of desire or a prediction?

Mr. BAXTER. That is a prediction.

Senator **Gorton**. On another subject, Mr. Baxter, reading pages 4 and 5 of your written testimony for today dealing with vertical restraints, it seems to me not inaccurate to characterize your statement that there has been relatively rare enforcement on vertical restraints in the last few years as arising from the statement you made in the previous sentence:

> Current economic analysis demonstrates that an individual firm's choice as to distributional arrangements . . . may simply reflect the firm's judgment about the most efficient and effective way to structure its marketing effects.

Is that correct?

Mr. **Baxter**. Senator, I am sorry. I didn't really follow the question.

Senator **Gorton**. All right. The question was that your next paragraph stating that your enforcement actions against——

Mr. **Baxter**. Where should I be looking, please?

Senator **Gorton**. I am on the bottom of page 4 and the top of page 5 of your testimony on vertical restraints. You are saying that vertical restraint actions have been relatively rare in recent years, not just in your administration but in the previous one, and I take it that that is based on your previous sentence dealing with a current economic theory about the effects of distributional arrangements. Is that correct?

Mr. **Baxter**. Well, Senator, I still do not find the sentence. I am sorry, but let me not trouble with that.

Senator **Gorton**. Well, it is the last sentence on page 4, the incomplete sentence.

Mr. **Baxter**. Of my statement dated September 9 to the Committee on Small Business?

Senator **Gorton**. Yes; next to the last line of page 4.

Mr. **Baxter**. Next to last line on mine says, "Indeed, current economic analysis demonstrates"——

Senator **Gorton**. That's the sentence. That's it; you've got it.

Mr. **Baxter**. A firm's choice. Yes, now, what is the question?

Senator **Gorton**. Well, the preliminary question was whether or not that was the theoretical basis for the next paragraph, that vertical restraint actions are relatively rare and, I take it, relatively unnecessary.

Mr. **Baxter**. Well, of course, that merely states a possibility. It is certainly true that an individual firm's choice of distribution arrangements will often merely indicate its views as to the most efficient ways to distribute its product. It is also true that they may represent quite different motivations, and the likelihood of the one or the other motivation being observed depends on the industrial context in which the practice occurs.

Senator **Gorton**. What I am troubled by, Mr. Baxter, to lead you to the specific question to which I want an answer, is the implication that if a firm finds what is the most efficient and effective way to structure its marketing efforts for itself, that that seems automatically to be in the consumer's or the general public's interest. Is it not frequently the goal of such arrangements to increase the profit margin on a certain item so that the company can make a far greater profit with a considerably smaller volume than would be the case with less formal arrangements?

If, indeed, that is the case, that the company is satisfied to take a larger profit on the smaller volume, how is that in the public or consumer interest?

Mr. **Baxter**. Well, of course, the case you describe would not be in the public or the consumer interest. On the other hand, I start with the assumption that a company will always behave so as to increase its own profitability if it has an opportunity to do so, and it is only the restraints of the process of competition in competitive markets that keeps it from doing so to a greater degree.

But it does not follow from that that efforts by an individual company to seek out its own best interest will in any sense be harmful. Indeed, they will not be if they occur in the context of competitive markets. If they occur in the context of highly concentrated markets or by firms with very large market shares, of course, outcomes may be different. But those are generalizations that cannot be made outside the context of some particular industrial context.

Senator **Gorton**. How many vertical restraint actions has the Department brought since you took your present position?

Mr. **Baxter**. I looked at some numbers there the other day. I think the answer is three or four, but I must say I am not certain. I don't have that number in front of me. I would be happy to answer.

Senator **Gorton**. Does that represent your view as to the lack of frequency of occasions in which these vertical restraints are in fact anticompetitive or anticonsumer?

Mr. **Baxter**. Undoubtedly, it does.

Senator **Gorton**. Mr. Chairman, I think I am finished for this round. Why don't you go ahead, and I will have some more for the next round.

Senator **Rudman**. I only have, really, one other question. I found your comment very interesting about the Supreme Court, you know, various courts not taking offense at disagreement. I would agree. I wonder, though, with some of the characterization of some of their decisions recently, whether you want to go over there again, Mr. Baxter. [Laughter.]

My question to you really is this. I want to talk about the *Apple* case for a moment. We will have testimony later this morning after you leave, and this goes to the whole area of the private action bureau or agency that you are trying to establish, or project, I guess it is, where you are going to get involved in a number of private actions, and I expect your reason is to influence court decisions to get outcomes which more consistently conform to what you believe the law is, in response to Senator Gorton's question.

Mr. **Baxter**. No, what I believe the law ought to be.

Senator **Rudman**. Oh, what it ought to be, but you think that the court has left even what the Congress thought the law ought to be. That was your answer to——

Mr. **Baxter**. Oh, yes. It means in closer conformity with the language of the statutes.

Senator **Rudman**. Now, in the *Apple* case, that case is familiar to most of us, and the fact as I understand it is that Apple Computer has essentially told its customers who want to continue to sell by mail order that if they sell by mail order they cannot buy from Apple.

There was an antitrust action that is involved there. It is our understanding that the Justice Department has indicated to Apple that it is going—this is one of the cases it will get involved in, if you will, a private action. Is that accurate?

Mr. **Baxter**. It certainly is a case that we are monitoring and are interested in. I don't think we have given any firm indication to the parties that we will participate in any particular way.

Senator **Rudman**. If you were to advise me at this hearing this morning, answer this question: Is it more probable or not that the Justice Department will get involved in the *Apple* case?

Mr. **Baxter**. It depends on how it develops procedurally and exactly what issues arise.

Senator **Rudman**. Now, if you had to take a wild guess right now, Mr. Baxter, could you tell me whether you think that—if you just had to take a guess, and you know that case pretty well, and I understand it has been well discussed by maybe your subordinates, maybe not by you, but isn't it pretty likely that that is such a significant case involving the antitrust laws that you probably will get involved in it?

Mr. **Baxter**. I would really be unable to put a more or less than 50 percent probability on it. I think there is a substantial chance we may get involved in it. It seems to me quite a good example of the kind of instance in which the existing per se rule can be harmful.

Senator **Rudman**. Fine. Then this is the question: If you get involved in that case, you will use a lot of resources in that case. Apple is a large corporation. I assume the people involved in the lawsuit have some resources. Why should the U.S. Government get involved in that case, with our hard-earned appropriated dollars? You've got resource troubles enough. Why not let Apple and the other company fight it out, and if you have a problem with the state of the law, why don't you do it a much more inexpensive way? Why don't you come to the Congress and tell us what you want to change? Let's do it that way, rather than having the U.S. Department of Justice running around the country, intervening in a number of antitrust cases and trying to change the law at the Supreme Court level?

Mr. **Baxter**. Well, in the first place, I don't agree that that is the least expensive way.

Senator **Rudman**. Oh, this is a very inexpensive morning for you, Mr. Baxter. [Laughter.]

Mr. **Baxter**. I haven't seen any new statutes written yet, either, though.

Senator **Rudman**. You haven't asked us to write any, either.

Mr. **Baxter**. No, I haven't. One of the problems with private enforcement—indeed, one of the problems with the antitrust laws—is the fact that they have largely been made in the context of private litigation. Now, in that context, each party is pursuing essentially its own commercial objective. It is another form of business rivalry, but it is taking place in a courtroom. Each party wants to win that case, and they want to win it any way that it can be won, and it doesn't much matter what kind of judicial doctrine they create in the process of winning it. Whatever doctrine or case law falls out of that controversy is a matter of indifference to them; somebody else will have to worry about that down the road.

Precisely because private litigation does have that context and effect, some of the most damaging doctrines of antitrust have emerged historically of private litigation. It was precisely because that is true that we thought it a highly desirable allocation of resources—and it is not a terribly expensive program—to pay some attention to what was going on in private antitrust litigation. Where we saw divergences, where we saw situations where the private parties, in pursuit of their own self-interests, were likely to create or reinforce unfortunate doctrine, it is our intention to step in and tend to the public interest in those very important cases to help insure that the doctrine that emerged from them was in the interest of consumers rather than merely an unintended fallout of this private activity.

Senator **Rudman**. Well, if you should intervene in the *Apple* case, it is likely you would intervene on the side of Apple, if I understand the Department's position. Correct?

Mr. **Baxter**. I don't know. I, myself, am not familiar in great detail with the facts of that case. I think I understand in general what it is about. At this time I am prepared to say only that it is the kind of context in which application of a per se rule against vertical price fixing or other vertical arrangements can have damaging economic consequences.

Now, whether that is the way the pleadings will develop or whether the case will really take that form, whether there will be an appropriate role for us to play, I am not at this time prepared to say.

Senator **Rudman**. I would suggest to you two things, Mr. Baxter. We certainly enjoyed having you as a witness, and we have a few more questions for you. Just two things. One, in the *Apple* case, if the Justice Department intervenes on the side of Apple in that case, two things: First, in terms of the whole judicial system working out there in the free market, that is kind of a tough battle—Apple and the U.S. Department of Justice—against some little distributor out there, no matter how well represented.

No. 2, I seriously question your answer on the competitive effects, the economic effects, if in fact the consumers are able to buy Apple equipment through their mail order distributors at a lower cost than they are at their local computer store. I just, for the life of me, and I really have tried to understand your theories here this morning and several months ago, do have to part company with you on that. You know, we may end up with some legislative action here in the Congress because many of us disagree rather strongly but certainly respect your opinions.

Senator Nunn?

Mr. **Baxter**. Well, I wonder if I could make a comment, Senator, before you go on.

Senator **Rudman**. You may, sure.

Mr. **Baxter**. I would hope in that regard, because I have not had an opportunity this morning to try to explain to you why I think that the application of the per se rule in that context would be harmful, that you might take a look at a letter that I think I have sent to the committee which explains that phenomenon in some detail. I would be happy to send up another copy if the committee does not have that letter.

It is not a simple explanation, and it is not an intuitively obvious explanation. Part of the way you state the problem, you see, is that you assume that a product has come into existence and then it is subject to a particular kind of treatment.

Now, given the fact that we have an Apple computer, yes, it probably in the short run is good for consumers if they can buy it through discount stores. The problem is that the incentive to invent, innovate, and develop complex products such as the Apple computer is itself strongly affected over the course of time by the rules that apply to the process of distribution.

The real question is whether we are going to continue to have Apple computers, if I can use that phrase in a representational sense, whether we are going to continue to have those products in abundance or in much more restricted forms because the rules of distribution that we now have are strongly punitive with respect to technologically complex consumer products.

Senator NUNN. Just one brief question which I will ask Mr. Baxter just to furnish for the record. It is obvious that you disagree with the law in a number of respects, and I think you said this morning, most of what you disagree with is case law rather than the broad wording of the statute.

Mr. BAXTER. That is correct.

Senator NUNN. Could you furnish for the record your own personal views on some of these issues. Whether we agree or disagree, it is obvious you are a very dominant force in this administration, and you are calling the shots on antitrust policy. I would like to have for the record your views as to what Supreme Court cases are wrong as they now exist today. I am speaking of major cases. I am not asking for an exhaustive review of every antitrust case, but the fundamental disagreements you have with the law as interpreted by the courts today in the antitrust area. Would you give us that for the record?

Mr. BAXTER. I will try to do that. That is quite a challenging undertaking, and I am sure it is something that I cannot do in the course of an afternoon.

Senator NUNN. I understand that. I am not asking you to look at every case that has ever been decided. I am saying the major cases at the appellate level that are taken as the law of the land in the antitrust area, the ones you most disagree with. It is obvious to me that that is where we are going under this administration in antitrust law, and I think we need to know it, because if you are going to pursue the legal avenue of challenging these in courts, in effect, rightly or wrongly, Congress is really being left out of the picture in terms of the legislative intent.

We may want to update our legislative intent; we may find that you are right in a number of these respects. But it seems to me that what is evolving now is antitrust law that is being designed exclusively through the court system and the Department of Justice and private suits, and that Congress itself is not part of that act.

It seems to me we have got to know where you are going and what your views are if we are going to really determine whether we want to express a new legislative intent in any of these areas.

Mr. BAXTER. I quite understand, and I will give you as helpful a response on that as I can.[1]

Senator NUNN. That is all I ask for. I am not asking for a review of every court decision that has ever been made, but the fundamental decisions that you have significant disagreement with.

Senator RUDMAN. Senator Gorton?

Senator GORTON. I would like to ask one or two questions about mergers, and I do so in the context of the proposals which are in the news right now.

Mr. BAXTER. Senator, I would prefer you ask them in almost any other context because I am not going to talk about pending cases.

Senator GORTON. Well, I think that the way in which I am going to ask about them will not interfere with your willingness to answer.

Mr. BAXTER. All right.

Senator GORTON. In connection with either the attempt by Bendix to take over Martin Marietta or the attempt by United Technologies to take over Bendix, are these properly characterized as conglomerate mergers?

Mr. BAXTER. I don't know the answer to that question. Conglomerate is a residual category as it is used in antitrust. If two companies, although they may do 100 things, each do something that puts them in head-to-head competition in some one area, we tend to talk about that as a horizontal merger.

Senator GORTON. Yes.

Mr. BAXTER. Obviously, in calling it a horizontal merger, we are focusing on the one thing that they have in common and not on the 99 points of diversity.

If United Technology Corporation manufactures anything that Bendix might buy, and they must, then one could call it a vertical merger, but then one would be focusing only on that particular aspect of the transaction.

Senator GORTON. I think, actually, you anticipated my second question as well, which would be that while perhaps most of the elements of each of those proposals are conglomerate in nature, each of those proposals almost certainly includes at least some horizontal aspects and/or some vertical aspects.

Mr. BAXTER. That seems likely to me, but I do not know that.

Senator GORTON. In connection with mergers of this type, primarily conglomerate, for the last decade or so, or during the entire time in which you have been observing the phenomenon and commenting on it, is it accurate to say that mergers of this type have been successful in the sense of creating significantly greater operating efficiencies on the part of the companies involved, or have they been successful only in the narrower sense of rewarding shareholders?

Mr. BAXTER. Well, obviously, there have been instances of both kinds. The only way one can make generalizations beyond noting instances of both kinds is through attempts to do statistical work on large numbers of instances, so that one can make——

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[1] See information beginning with letter dated September 15, 1982, page 114.

Senator **Gorton**. Have you seen studies?

Mr. **Baxter** [continuing]. Studies, statistical generalizations. I am sorry?

Senator **Gorton**. Are you familiar with any such studies?

Mr. **Baxter**. Oh, indeed, I am.

Senator **Gorton**. Can you share with me their conclusions?

Mr. **Baxter**. Yes. Well, you see, the difficulty is that the way these studies generally are done is through the securities markets effects, and if the securities are worth more after the merger than they were worth separately before the merger, carefully controlling for changes in stock market levels and price levels and other things, then the inference is that the merger was economically desirable, so that it does make the separation which is implicit in your question between good for shareholders and good for the economy in some more abstract sense.

Senator **Gorton**. Well, almost all of those studies are based solely on whether they are good for shareholders or not, rather than being good for the economy.

Mr. **Baxter**. Yes, they are. Now, there are very, very persuasive reasons to think that if a merger is good for shareholders, then, in the absence of some peculiar tax effects, it is also good for the economy. It shows that the resources are being put to uses which are more highly valued now than they were before.

On the other hand, one cannot rule out absolutely the possibility that those studies are affected to some degree, perhaps to a significant degree, by tax effects, and that is what may explain them.

If I may assume for the moment that tax effects are not the dominant explanation for what those studies show, I would characterize the studies as showing the following things: First of all, the selling shareholders came off very, very well. Second, the buying shareholders just about broke even, so that in combination, the mergers were probably profitable but not by much more than the magnitude of gain to the selling shareholders.

Nevertheless, since the buying shareholders did not lose what the selling shareholders won, it strongly suggests that the buying shareholders were able to make the resources perform enough more efficiently to pay that premium to the selling shareholders.

In that sense, I would say that the studies tend to show, on balance, that the mergers were socially desirable, but the case is not as powerful a one as I would have guessed that it was going to be if someone had asked me to guess in the beginning. Still, I think it is unambiguous in the direction it points, if not in the magnitude.

Senator **Gorton**. I believe that the last time you were here, you made a statement to the effect that at least some of the economic effects of mergers were both beyond the antitrust laws, beyond your jurisdiction and beyond your willingness to comment. I am, nevertheless, going to ask such a question again.

In connection with Bendix/Martin Marietta, one reason for the proposal seems to be the fact that Bendix has a large amount of cash or assets readily convertible into cash, and that from its point of view the stock market prices for the company which it seeks to buy are under value. Therefore, it is economically rational for the corporation to spend that money on buying stock in another existing corporation, as opposed to spending it to go into all or some of the same businesses by building new plants and equipment and the like.

Is that private advantage automatically a public advantage? Might not the Congress feel that it is much more important, through tax laws and otherwise, to encourage companies with large amounts of cash such as Bendix to go into new businesses on their own, build new plants and equipment, and the like? Could we not quite rationally make that decision?

Mr. BAXTER. Well, I can readily imagine that you might want to do a variety of legislative things that would encourage new investment, and indeed, a large part of the President's program consists of suggestions about things that would encourage new investment.

I certainly agree with what I take to be your observation that the acquisition of Martin Marietta by Bendix would not inherently involve new investment in any sense. On the other hand, no investment capital is used up in the process, either.

Now, what can we say of it? Why does Bendix seem to attach a higher value to those shares than all those smart professional securities traders up on Wall Street? Martin's shares had been trading, as I recall, in the high thirties or midthirties, and Bendix comes along and values them in the mid, now the high forties, about a 33-percent higher valuation than was being attached to those shares by Lehman Brothers and White and Weld and thousands and thousands of very smart professional investment advisors. Why does Bendix do that? Will they be able to make those assets pay off and justify that high price?

Well, that goes back to what I was saying a moment ago. Historically, firms on average have been able to justify acquisitions at values substantially higher than market values of the stock. The only real possibility is that, for some reason or other, Bendix does not think those resources are being managed as well as they could be. Bendix is betting its own money, its own shareholders' money, that it can take over those assets and make them perform 33 percent more effectively than those assets are now performing. I don't know whether they can do that. I suggest, with due respect, that you don't know whether they can do that, and neither of us will know until the acquisition occurs and has been in effect for 2 or 3 years. Then we may be able to form a judgment on that.

Senator GORTON. On the contrary, Mr. Baxter, I don't really think that is responsive to my question. I assume that the people who have made that decision on the part of Bendix know much more about this subject than I do and are making a highly rational decision from the present point of view of their own business.

My question had to do with something quite different. It had to do with whether or not we might, as Members of Congress, quite rationally determine that we don't want money spent that way, that we wish at least to make tax laws relating to mergers neutral, and perhaps even punitive, in order to meet a goal of seeing to it that companies in a position of Bendix build new capital equipment with their excess money rather than buying other companies.

I am simply asking you whether or not you believe that would be a highly rational decision, even though it may be a little bit beyond the field of antitrust.

Mr. **Baxter**. Well, I would say this: If there are laws that are not neutral, if there are laws that really make those kinds of acquisitions preferable to new investment even when new investment would be socially preferable—and new investment is not always socially preferable—then, by all means, they should be changed. On the other hand, I would regard it as very unwise to pass laws which were punitive as to such acquisitions. I think that neutrality is precisely the thing to strive for in that respect.

Let me try to give an illustration of what I mean. At the present time, it is quite clear, I think, to all observers that there is substantial excess capacity in the passenger automobile tire industry. Given those circumstances, it may, nevertheless, be desirable, for a variety of reasons, for one tire company to acquire another tire company. It certainly would be undesirable to encourage someone to go out and build substantial new production facilities. We already have too many of them, for a variety of reasons.

So we do not always want to prefer new investment to merely a——

Senator **Gorton**. But not necessarily undesirable, in that same theoretical situation, to have that new tire company go out and build a plant to manufacture something entirely different.

Mr. **Baxter**. That is quite right.

Senator **Gorton**. Thank you, Mr. Chairman.

Senator **Rudman**. Mr. Baxter, we thank you very much.

What I would like to suggest to you is we keep the record open until the September 23 to give us an opportunity to get questions to you very quickly that might be answered for the record and for such other responses as you wish to furnish for the record. Does that give you ample time, September 23?

Mr. **Baxter**. Oh, I believe it will.

Senator **Rudman**. Fine.

Mr. **Baxter**. I mean, if we receive the questions relatively soon——

Senator **Rudman**. We will make sure that you do. They will come in very soon.

Thank you very much for appearing here this morning, and we will get your further answers for the record.

Mr. **Baxter**. Thank you, Senator.

Senator **Nunn**. Thank you, Mr. Baxter. Mr. Chairman, I would like to add two documents for the record. The first is an exchange of correspondence with Mr. Jalil of Elberton, Ga. The second is a brief article entitled "Justice's Double Standard," by Timothy Fine, Acting Chairman of the Democratic National Committee Task Force on Antitrust and Regulation.

[Material follows:]

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United States Senate
COMMITTEE ON SMALL BUSINESS
WASHINGTON, D.C. 20510

September 15, 1982

Honorable William F. Baxter
Assistant Attorney General
Department of Justice
10th Street & Constitution Ave., N.W.
Washington, D.C. 20530

Dear Mr. Baxter:

Enclosed are questions submitted by the Members of the Committee with regard to the Administration's antitrust enforcement policy and merger guidelines.

I would appreciate your response to these questions by September 29, 1982.

In addition, I want to remind you of the request by Senator Nunn to provide the Committee with your review of those significant areas of the antitrust laws which you disagree with. Any analyses of these areas accompanying your response would be useful to the Committee, as well. Of course, the Committee recognizes that it may not be possible to fully comply with this portion of the request by the September 29 deadline. Your expeditious response, however, would be appreciated.

Your continued cooperation is most appreciated.

Sincerely,

LOWELL WEICKER, JR.
Chairman

Enclosures (Omitted.)

U.S. Department of Justice

Antitrust Division

Office of the Assistant Attorney General *Washington, D.C. 20530*

NOV 1 8 1982

Honorable Lowell Weicker, Jr.
Chairman
Committee on Small Business
United States Senate
Washington, D. C. 20510

Dear Mr. Chairman:

I am happy to provide the enclosed responses to the questions submitted to me following my appearance before your Committee on September 9, 1982, with regard to the Department's revised merger guidelines and antitrust enforcement policies. We are still in the process of considering our response to the question posed by Senator Nunn during the hearing asking that we identify the significant Supreme Court substantive antitrust decisions with which we disagree. We expect to provide that information to the Committee in the near future.[1]

I appreciate this opportunity to provide this information for the record, as well as the interest of your Committee in the antitrust enforcement activities of the Department of Justice.

Sincerely,

William F. Baxter

William F. Baxter
Assistant Attorney General
Antitrust Division

Enclosure

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[1] The answer to Senator Nunn's question had not been received at time of going to press.

FISCAL YEAR 1982 FUNDS

Question: Although the 1982 appropriation ($44,000,000) for the Division was nearly a million below 1981 funding levels, it was still able to absorb all of its pay costs and it had $2.8 million in excess funds which could be used to offset pay requirements elsewhere in the Department. Can you tell us why the Division had so much available this year?

Answer: At the beginning of Fiscal Year 1982, Congress reduced the Division's budget request by $5.6 million dollars, or 11 percent of its original request. This reduction was made to a request that already reflected reductions from the prior year base. It was apparent that the Division did not have adequate funding during Fiscal Year 1982 to continue its two major cases, United States v. International Business Machines and United States v. American Telephone & Telegraph Company, and still maintain its other activities at the 1981 level. To meet the funding requirements of these two cases: (1) a field office was closed; (2) personnel were transferred to U.S. Attorney offices; (3) computer support for new and ongoing matters was reduced to levels that could not long be sustained; (4) a virtual freeze was imposed on new hiring; (5) travel and overtime were reduced to levels that could not be sustained; and (6) equipment purchases and training were reduced by one-half. The two major cases were satisfactorily resolved in January, but even then it was not clear what resource requirements would be imposed by further proceedings in the two cases. Hence, we continued to implement the above-stated drastic measures to hold expenditures down. When costs associated with the two big cases proved to be lower than was expected, the Antitrust Division was left with $2.8 million in surplus funds in Fiscal Year 1982.

Question: Why weren't these funds used to fund some of the 35 positions reprogrammed out of your competitive market structure program? (NOTE: Total position reduction was 68 of which 35 was from the competitive market program.)

Answer: When Congress reduced the Division's Fiscal Year 1982 budget request by $5.6 million, it did not reduce the number of the Division's authorized positions. Since the Division's budget is used primarily to pay the salaries and support costs of its employees, it was necessary to reduce the number of positions accordingly. The number of authorized positions was reduced by 68, with 35 of these positions coming from the preservation of the competitive market structure program on the assumption that the AT&T and IBM cases would eventually be terminated and the positions associated with these two cases could be reduced from this budget program. Given the substantial lead time necessary to recruit qualified personnel, by the time it was apparent that the Division would in fact have a substantial surplus, it was too late to begin recruiting additional staff. In addition, uncertainties regarding funding for the Division during future budget years made it appear unwise to embark on an extensive recruitment effort.

IMPACT OF POSITION CUTS

Question: In March 1981 we were told that 33 positions were assigned to the IBM and AT&T cases. Since that time there has been a reduction of 35 positions in the competitive market program and the current budget proposes another reduction of 11 positions--for a total cut of 17 percent in less than two years. Since the total cut exceeds the resources assigned to your largest cases, what impact do you anticipate the reduction will have?

Answer: These staffing reductions will have little impact on productivity levels. Recent reductions have been applied proportionately to all Division programs. It is expected that the continued use of sophisticated computer support programs and application of modern management techniques will yield increased efficiencies that should compensate for these staffing reductions.

PRIVATE ACTIONS PROJECT

Question: The Antitrust Division's appeal to the budget reduction proposed by the House Appropriations Committee states that the "Private Action Project has entered an accelerated phase". Would you please elaborate on the objectives of the Private Actions Project? What do you hope to achieve?

Answer: In enacting the substantive provisions of the antitrust laws, Congress recognized the wide diversity of business practices that were or could be utilized. Congress also recognized that a detailed set of prohibitions would lack the flexibility needed to deter anticompetitive conduct in the numerous and varied contexts in which it might arise, while at the same time allowing vigorous competition. In order to provide this essential flexibility, Congress proscribed anticompetitive practices in broad statutory language and left to the courts the task of refining and implementing the statutory language on a case-by-case basis.

By and large, the courts have done an excellent job in implementing the congressional goal of preserving competition. However, some areas of antitrust law exhibit substantial doctrinal confusion and in extreme cases impose substantial barriers to the efficient operation of firms and markets. Whether these problems had their source in historical accident or inadequate economic theory at the time of the early decisions, it is in our country's vital economic interest to correct these misinterpretations so that courts may rely on sound precedent. The so-called "private actions project," along with speeches, pleadings filed in antitrust cases in which the United States is a party, and our exercise of prosecutorial discretion, are all vehicles through which we hope to bring to the attention of the courts the problems of current antitrust jurisprudence and suggest solutions which will promote, rather than impede, competition.

Question: On what basis will the Division determine to intervene at the District Court level?

Answer: The Division will consider participation as amicus at the district court level where (1) the issue before the court is one of significance to the proper development of antitrust jurisprudence; (2) precedent is nonexistent or supports an interpretation of the law which raises barriers to the efficient operation of firms or markets; and (3) the essential facts are not in dispute. The Division will consider equally supporting the position of either plaintiffs or defendants in this regard.

Question: Has the Division filed amicus briefs in any cases before the lower courts?

Answer: During the period January 20, 1981 to date, the Division has filed ten (10) amicus briefs before United States Courts of Appeal. */ At the request of Chief Judge Peltine the Division, in December 1981, filed a memorandum amicus curiae in the Federal District Court for the District of Rhode Island in D&B Auto Body Inc. v. Allstate Insurance Co., Civ. No. 79-0550, regarding the application of the McCarran-Ferguson Act

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*/ This statistic includes two Court of Appeals briefs filed on October 1, 1982, and November 3, 1982, which are not reflected in the answer to the following question.

(insurance exemption) to certain contracts and other alleged acts of automobile insurance companies affected the prices paid for auto body repairs. The case was subsequently settled.

Question: For the record, please provide the Committee with information regarding the number of cases in which the Division has filed amicus briefs at the District and Appellate court level over the last five years.

	FY 78	FY 79	FY 80	FY 81	FY 82
Supreme Court	6	4	3	10	8
Courts of Appeal	4*	3	8	6	5
District Courts	0	0	0	0	1**

* Including one state appellate court

** By request of court

Question: What funds are requested in the 1983 budget to support these intervention activities?

Answer: We have not requested any additional funding for this project; this activity will be funded from within the existing Antitrust Division budget program.

QUESTIONS FOR MR. BAXTER
(RESALE PRICE MAINTENANCE)

Question: In responding to written questions previously submitted on the subject of resale price maintenance (following the December hearing before the Subcommittee on Productivity and Competition) you submitted a letter dated June 18, 1982 and addressed to Congressman Robert McClory. This letter did address itself to the subject matter of most of the questions with one particular exception. Please directly respond to the following unanswered question:

In cases where product differentiation has created strong product loyalty for a particular brand among a significant subgroup of consumers, won't intrabrand competition become especially important since interbrand competition won't fully protect those consumers? What is your view of RPM in that circumstance?

Answer: My view is that resale price maintenance (RPM) should not be condemned as *per se* unlawful because there are many circumstances in which the practice has beneficial procompetitive effects. Therefore, even if I accepted the implication of the question that RPM is always harmful in the situation you describe (which, as I explain below, I do not), it would still be my position that RPM should not be universally condemned.

I have great difficulty, however, with the suggestion that RPM should be automatically condemned even where strong product differentiation exists. Such differentiation often reflects the manufacturer's efforts to create a product with superior quality or other desirable features; outstanding efficiencies in the production or marketing processes; or superior foresight in selecting the manner and timing of productive investment and other risk-taking activity. Naturally, these highly desirable manufacturer activities deserve to be compensated. No doubt less deserving instances of "strong product loyalty" could be found. But if rewards, deserved or not, are available to a manufacturer, he will capture them by increasing his wholesale price above his costs. RPM is not a device well adapted to garnering such rewards.

On the other hand, to create a product with superior quality, the manufacturer may be required to induce his dealers to provide services and information to consumers, and RPM may be the most efficient inducement. Thus, to the extent that RPM is used to encourage dissemination of information about a products' qualities, it should not be condemned. To do otherwise threatens the most basic economic forces of entrepreneuership that propel our industrial economy.

Of course, wherever RPM is employed to facilitate collusion, it should be condemned. RPM might be employed for this undesirable purpose, and therefore, it may perhaps be properly condemned in markets where product differentiation has vested strong product loyalty.

Question: On page 7 of the June 18 letter to Congressman McClory you agreed that resale price maintenance can have anticompetitive consequences "in a more common set of circumstances" than other vertical restraints. Since you believe it is not difficult to distinguish those circumstances, and because you believe the *per se* Rule is too rigid, you nevertheless favor a "Rule of Reason" approach. Many authorities disagree with you that the circumstances in which resale price maintenance may be harmful are easy to identify and believe that the "Rule of Reason" goes too far in the direction of encouraging the practice. What is your view of a middle ground approach which would create a rebuttable presumption that resale price maintenance is an unreasonable restraint of trade?

Answer: Resale price maintenance (RPM) potentially can have adverse anticompetitive effects only when used to facilitate collusion among manufacturers or dealers. */ As I have indicated on previous occasions, the greatest potential danger of RPM is its use as a facilitating device for a cartel of manufacturers; however, it is not difficult to identify the circumstances in which there is a possibility that RPM would be so employed: One likely would observe a market structure at the manufacturing level that is conducive to collusion--that is, a highly concentrated market, a homogeneous product, widely-available current transaction price data, low rates of change in industry technology and product characteristics, and slow market growth. One would also expect a prevalent (if not uniform) use of RPM by the manufacturers in that market. In these circumstances, a rebuttable presumption of illegality is an approach that merits further consideration. Indeed, the suggested approach is not too dissimilar from the "structured rule of reason" approach that I have advocated in which courts would consider the type of practice and the structural

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*/ Of course, where evidence (other than of RPM itself) establishes a horizontal agreement among competing manufacturers or dealers to fix prices or restrict output, and RPM is merely used to enforce or facilitate that horizontal agreement, the agreement is per se illegal and the presence of RPM would not alter that conclusion.

characteristics of the market and product or service involved, and would undertake factual inquiry only so far as required to reach a conclusion as to the probable competitive effect of the practice, in light of the economically-sophisticated analysis mandated by GTE Sylvania. In that fashion, competition would be protected and oversimplified rules and economically counter-productive results could be avoided without undertaking an open-ended factual inquiry in every antitrust case decided under the rule of reason.

In the other situation in which RPM may have anticompetitive effects (i.e., its use to enforce a dealer cartel), as I pointed out in my letter to Congressman McClory to which you referred, manufacturers have every incentive to prevent the formation and continuation of collusion among dealers. Such possibility of RPM being used to facilitate collusion at that level, then, is more apparent than real, and the instances in which RPM is used to facilitate a dealer cartel are likely to be extremely rare. Accordingly, it would be inappropriate to presume that in the absence of a market structure conducive to manufacturer collusion, RPM harms consumers because the likelihood of its use to enforce a dealer cartel will be very low. Of course, where other evidence establishes the existence of dealer price collusion, then it is clear that consumers are harmed by an illegal horizontal violation of the Sherman Act--a violation that should be assiduously prosecuted and severely punished.

Unless use of the presumption is limited to the circumstances in which RPM has any realistic potential for harm, there might be a tendency for courts to define overinclusively the circumstances in which the use of RPM was being used to facilitate a dealer cartel, and many innocuous instances of RPM (probably far greater than the number of actual dealer cartels) would likely be swept into such a presumption. Furthermore, it would be relatively difficult for a defendant to prove in specific instances to a court's satisfaction that a resale restriction was procompetitive. Thus, creating a general rebuttable presumption that RPM is illegal (other than perhaps where manufacturer collusion is otherwise indicated) because of the relatively remote possibility that RPM is being used effectively to enforce a dealer cartel, like the present _per se_ rule of illegality, frequently would condemn instances of RPM that are not anticompetitive. As with the present _per se_ rule, the effect of using a rebuttable presumption of illegality might also unnecessarily force manufacturers to use less efficient methods of distribution.

Thus, while the notion of utilizing a rebuttable presumption of illegality concerning RPM in only those narrow circumstances described above in which there is a possibility that the practice was being used to facilitate a manufacturer cartel deserves further consideration, there is no reason otherwise to utilize such an approach. Indeed, the use of such an approach in all instances will impose unnecessary burdens and costs on distribution (including the costs of defending distribution practices that become the subject of litigation) that could be avoided if a structured rule of reason approach were utilized in all instances in which RPM occurred.

QUESTIONS FOR WILLIAM BAXTER

I. You recently expressed the belief that manufacturers of technologically complex products like cameras, stereos, calculators and personal computers should be allowed to specify minimum retail prices, because you felt that otherwise, retailers would not provide the trained staff needed to sell those goods.

However, on page 27 of the Justice Department's new Merger Guidelines, it is stated that the Department is more likely to challenge a merger if most or all firms in a given market adopt:

1) Mandatory delivered pricing;

2) Exchange of price or output information in a form that could assist firms in setting or enforcing an agreed price;

3) Collective standardization of product variables on which the firms could compete; and,

4) Price protection clauses.

Furthermore, the guidelines state:

"Although not objectionable under all circumstances, these types of practices tend to make collusion easier, and their widespread adoption by the firms in the market raises some concern that collusion may already exist."

Question: Is not your position, that some manufacturers should be allowed to dictate retail prices, at odds with the merger-challenging criteria contained in the Merger Guidelines prepared by your very office?

By not enforcing the law which prohibits retail price setting by manufacturers, are you not fostering the establishment of the very factors described in the Merger Guidelines that can facilitate collusion over the longer run?

Answer: Our position on resale price maintenance (RPM) is entirely consistent with the revised Merger Guidelines. As I have stated on numerous occasions, and as is expressed on page 7 of my letter of July 18, 1982, to Congressman McClory (referred to in the previous Question and Answer), RPM may have anticompetitive effects under limited circumstances, as where it is used to facilitate a cartel, and thus may violate the antitrust laws in those circumstances. While the Merger Guidelines describe certain practices that may facilitate collusion, the Guidelines also state (as recognized in your question) that those practices are not always objectionable. They become objectionable only when the market is otherwise conducive to collusion and when the practices are used extensively. If those conditions are absent, however, the practices generally enhance efficiency. Merely because, for example, price protection clauses may be used to facilitate collusion, it has never been contended seriously that they should be *per se* illegal in all situations.

Similarly, RPM effectively can facilitate collusion only when the structure of the market is otherwise conducive to collusion and the practice is extensively utilized. Furthermore, because RPM frequently enhances the efficiency of distribution, it may have a greater procompetitive potential than the practices listed in the Merger Guidelines. Therefore, it makes no more sense (and perhaps far less) for RPM to be per se unlawful in all cases than it does for the practices listed in the Merger Guidelines to be unlawful in all instances.

I also disagree with the assumption in the second part of your question that I am "not enforcing the law" with respect to RPM. Because of the limited resources that Congress is able to appropriate for the Justice Department and the federal judiciary, it is impossible to prosecute every single instance in which a technical violation is identified. Accordingly, as is true of every law enforcement agency, the Department must use its discretion to employ the available resources in the most effective manner.

In my view, effective deployment of the resources available to the Antitrust Division requires us to bring those cases that will yield the greatest gains for consumers. The various areas of antitrust enforcement differ in the frequency with which a case arising in the area will have the potential substantially to benefit consumers. The area of RPM, like many other areas, is populated by some cases the successful prosecution of which would yield great consumer benefits, and other cases that would yield only losses to consumers if successfully brought. If I became aware of a situation in which prosecution of RPM would significantly benefit consumers, I would prosecute it.

Of course, wherever RPM is imposed as the result of direct collusion among dealers or among manufacturers who otherwise are direct competitors, it will be vigorously prosecuted.

II. Question: In purchasing a product, should not consumers be free to elect whether or not they want point-of-sale services? To the extent that prices are lower without point-of-sales service, shouldn't it be up to the consumers to do without the service if they feel it's worth the price difference to read the instructions themselves? Conversely, should not consumers be free to elect to pay a high price to receive point-of-sales services?

Answer: If consumers do not desire services (point-of-sale or otherwise) provided in connection with the sale of a manufacturer's goods, they are, of course, free to purchase, presumably at a lower price, the goods of a competing manufacturer who does not provide such services. However, a different question is presented if one asks whether consumers should have the choice of purchasing services separately when they purchase any single manufacturer's products.

A particular manufacturer's decision to impose resale price maintenance (RPM) in order to induce his dealers to provide certain services in connection with the sale of his products reflects a recognition that the most effective marketing of the product requires some mixture of price and non-price attributes. In order to market his goods successfully, that manufacturer must judge the amount of services desired by customers and establish the resale price so as to induce the offering of that level of services by his dealers.

The manufacturer has no incentive to encourage, through RPM or any other distributional restriction, his dealers to provide services unwanted by the consumer. If the retail price of the product is raised too high, the manufacturer will lose sales and thus profits; if it is set too low, the desired amount of services may not be provided and again, potential sales and profits will be lost. Therefore, we can expect manufacturers to be in the best position to determine whether, and to what extent, consumers demand such services (as they typically do when purchasing complex, multifeatured goods) and to take steps to see that they are provided accordingly.

Market imperfections generally make it difficult to price services, including those at the point of sale, separately from the product to which they relate because of high transaction costs and because it may be impractical to charge separately for them. For example, it will be difficult for a consumer to place a value on services until he or she has obtained them; however, once the product has been explained and demonstrated, it will be difficult for the retailer to obtain value for the service if the consumer decides against purchasing the product without jeopardizing its good will.

Because it is so difficult to charge separately for services, it is difficult to prevent potential customers from obtaining services without paying for them where the dealer is forced to give each consumer a choice whether or not to pay. This situation may result in the so-called "free-rider" problem that can erode dealers' incentives to provide any services. Suppose a manufacturer desires his dealers to provide certain services in connection with the sale of his product and merely encourages them to do so, without employing RPM. A manufacturer who does so will be aware that the selling practice he desires is more expensive than alternative selling practices, and he will know that the retail price will have to be high enough to cover the costs a distributor incurs in following that practice. If some of his distributors adhere to the expensive distribution mode and others save costs by refusing to do so, the uncooperative retailers will be able to profit by reducing the retail price below the costs of the cooperative ones because they will have lower costs.

But if some distributors are incurring costs by following the agreed sales procedure and are selling at a higher price which covers those costs, while other distributors are not doing so and sell at lower retail prices, then the free rider phenomenon will appear. A substantial number of customers will go to the higher price outlet, will consume the time of sales personnel there to obtain the appropriate counseling, but will then leave without buying and purchase from a low-cost outlet instead. It will prove to be impossible for some retailers to afford expensive point of sale services for which it is not practicable to impose a separate charge if other distributors are not doing so and are selling at prices which reflect the cost savings of not doing so. If the manufacturer is to be successful in controlling the manner in which his product is sold and the quality of point of sale services afforded in conjunction with sale of his product, he must be able to shelter the gross margins of those distributors who are complying with his wishes from the pricing pressure of distributors who are not.

I emphasize that in speaking of a manufacturer protecting his distributors' margins, I am not suggesting that he will enable those distributors to earn more than competitive profits. Protection of their margins is necessary and is afforded because their costs are higher as a consequence of their compliance with their undertaking to market the product as agreed. As stated above, it would be inconsistent with the profit-seeking objective of the manufacturer to let his distributors earn profit above the competitive level. Accordingly, he has every incentive to authorize a sufficient number of distributors who will sell the product as agreed so that rivalry between them will eliminate any but competitive profits.

III. Question: By permitting manufacturers to set minimum retail prices, are you not preventing well-established businesses with low overhead costs from passing on those lower costs in the form of lower retail prices? If so, wouldn't you agree that allowing manufacturers to set minimum retail prices is anti-competitive?

Answer: No. A manufacturer desiring to use resale price maintenance (RPM) has every incentive to select a resale price that provides his dealers with a gross markup just large enough to cover the dealers' overhead costs and other expenses incurred in providing the desired demand-increasing services plus a competitive profit (that is, enough to prevent the dealers from deciding not to sell the manufacturer's products). The manufacturer maximizes the sale of his products by setting his resale price at the lowest possible level. Consequently, the manufacturer has very strong incentives to set his resale price at the minimum necessary to induce the efficient provision of the optimum amount of services; certainly, a business has no incentive to set the resale price above the minimum in order to give away its own potential profits to efficient dealers and/or unnecessarily allowing inefficient dealers to compete effectively with more efficient ones. Thus, rational use of RPM does not prevent efficient businesses from passing on lower costs to consumers because manufacturers have powerful incentives to select a lower minimum resale price when dealers are efficient. To the extent that some dealers could profitably charge prices lower than that set by the manufacturer, those dealers can be expected to provide more services than less efficient dealers. Thus, any cost savings of such efficient dealers may be passed along to consumers in the nature of enhanced services.

If, however, dealers' low overhead costs reflect not their efficiency, but their failure to provide the brand-enhancing services desired by manufacturers, the free rider effect described in the answer to Question II above may occur. Thus, in order to prevent free riding by those low-overhead dealers who do not provide desired services, the manufacturer understandably will want such dealers to increase their services and thus their overhead costs, and therefore will not allow them to lower their price to consumers below the level required to cover the cost of those services. RPM, then, is neither anticompetitive nor does it injure consumers when used to combat free rider effects. Rather, it fosters a mix of price and non-price competition intended to maximize the sale of the manufacturer's products.

I would re-emphasize that it is not in the manufacturer's interest to subsidize his inefficient distributors at the expense of his efficient ones. The manufacturer who sets his retail price too high so that efficiencies of his distributors cannot be passed on to consumers will tend to lose those efficient distributors to other manufacturers and/or lose sales and profits. That is, competition will discipline a manufacturer's misguided decision that fails to set the resale price at a level that takes advantage of efficient distributors.

Question: You have said that the Merger Guidelines were difficult to write, and that you tried to be explicit in the enumeration of factors that will be taken into consideration. How does such a complex element of the Guidelines such as how the geographic market will be defined contribute to the businessman's understanding of whether a particular action will meet with the Department's approval?

Answer: Section 7 of the Clayton Act prohibits those mergers or acquisitions that are likely substantially to lessen competition in any line of commerce in any section of the country. Analysis of the likely competitive effects of a proposed transaction, then, requires defining the relevant product and geographic market in which those effects are to occur. This is, of course, a complex, fact-oriented proposition, with those doing the analysis exercising their best judgment and discretion. Rather than attempt to describe particular markets, the Guidelines outline in detail the conceptual approach that will be used in defining relevant markets. In this regard, they are considerably more explicit than were the 1968 Guidelines, which did not describe how the Department went about defining markets. Over time, business executives, or at least the legal advisers who inform businessmen about the Department's likely enforcement intentions, will gain a fuller understanding of the Department's conceptual approach and should be able to gauge fairly well how we are likely to view proposed transactions. While we could perhaps increase certainty at the expense of injecting considerable arbitrariness into our evaluations, we do not believe such an approach would be either desirable or in keeping with the congressional mandate of Section 7.

Question: The Federal Trade Commission, in their horizontal merger enforcement statement, indicated that while they would give "considerable weight" to the Justice Guidelines, market share data may not accurately measure the market power of merging firms. Is the Federal Trade Commission going beyond the Justice Department in their analysis? Do the additional elements in the Federal Trade Commission's review remove any of the certainty in antitrust enforcement that may be expected from the two agencies?

Answer: While I cannot speak for the Federal Trade Commission, I do not think that the Department and the Federal Trade Commission are very far apart in this regard. In the new Merger Guidelines, factors other than market shares and concentration are given considerable weight because they are very important in determining the likely competitive effects of mergers. The Federal Trade Commission fully agrees with this proposition, but prefers not to publish specific market share and concentration standards. On the other hand, numerous public statements by Commissioners and Bureau Directors of the

Federal Trade Commission indicate the numerical standards in the Department's Guidelines will be given great weight. While it might have increased certainty if the Commission had simply adopted the Merger Guidelines in toto, I do not believe that the Commission's statement has created any significant uncertainties.

Question: It is my understanding that the kind of economic analysis required by the new Merger Guidelines has been accomplished by the Division only a few times so far. Doesn't a reliance on the complicated factors of market definition, and market power create an overreliance on hypothetical evidence to determine the Department's enforcement strategy?

Answer: Section 7 of the Clayton Act prohibits mergers whose effect may be substantially to lessen competition in any line of commerce in any section of the country. Enforcement of this provision requires that a prediction be made about the likely effects a merger will have on competition in the relevant market. While predicting future effects does, of course, involve asking some hypothetical questions and engaging in some speculation, reasonably sufficient tools have been developed to make informed judgments. Moreover, it would not be desirable to modify the law to eliminate the need to assess the likely competitive effects of proposed mergers and acquisitions. Simple objective prohibitions against mergers surely would be a far cruder approach and less desirable than present Section 7 requirements.

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United States Senate
COMMITTEE ON ARMED SERVICES
WASHINGTON, D.C. 20510

June 1, 1982

Mr. A. Jalil
Georgia Synthetics, Inc.
Post Office Box 962
Elberton, Georgia 30635

Dear Mr. Jalil:

I appreciate your following up our recent conversation with your letter of April 20 providing me the alarming information regarding consolidation in the synthetic carpet backing industry.

I have shared this with my colleagues on the Small Business Committee, and we will continue to be on the alert to these dangers. Unfortunately, the present Administration appears to be moving in a different direction. We have already had one hearing on the Reagan Administration's antitrust policies, and we will continue to pursue this.

Sincerely,

Sam Nunn

GEORGIA SYNTHETICS, INC.

P. O. Box 962
Elberton, Ga. 30635

Telephone 404-283-7510
TWX: 810 766-4484

April 20, 1982

The Honorable Sam Nunn
United States Senate
Washington, D.C. 20510

Dear Senator Nunn:

It was a pleasure to have met with you briefly last Friday.

Administrations recent Guidelines on Mergers state that vertical acquisitions are accepted. This is going to lead to acceleration of the process of "Consolidation" that has been taking place for quite some time.

Here are the facts: In 1974 the 500 largest industrials represented

66% of the sales of all U. S. Industrials, and
72% of the total Industrial profits, and
had 15.3 million total employees.

Since the percentage share of the 500 in total sales had been rising over the years, Fortune stopped giving this percentage any more and upon my inquiry stated that it was no longer possible to calculate the same.

The number of employees in 1981 is still 15.6 million and the sales have jumped from 833 billion since 1974 to 1,773.4 billion in 1981.

Standard Oil of Indiana is today completely vertically integrated and controls almost 70% of the synthetic carpet backing market.

While petroleum prices have been coming down, the manufacturers of polypropylene resin, of which there are only 6, have managed to increase the resin price by 10% during 1981 and 6% during the last 4 months.

To make things worse for independent producers like us, Standard of Indiana's subsidiary Amoco Fabrics, during this period has reduced the selling price for carpet backing by almost 15% with the result that the other producers of carpet backing, including ourselves, are suffering huge losses and some of us may not be able to sustain these for long.

The obvious conclusion is that Amoco Fabrics intends to capture practically the entire carpet backing market and then dictate their own prices.

The one thing that distinguishes private enterprise from public enterprise is its ability to be innovative, take risks and react quickly. These qualities are no longer to be found in any of the 500 large corporations who are bogged by the same process of checks and balances as in any public institution.

These large corporations have developed strnegth to be able to fix their prices on the basis of "cost" whereas the rest of the industry has to price its products on the basis of supply and demand which is the fundamental of the private enterprise system.

With best regards,

Yours sincerely,

A. Jalil

AJ/cw

P. S. Hereunder are some more facts realting to "Consolidation" that has taken place:

> In 1979 there were 24 carpet yarn spinners.
>
> 11 of those had 76% of the market.
>
> During 1980-81, 8 of these spinners either had to close down or were bought by other larger spinners all vertically integrated carpet mills who received price discount on synthetic fibers from the chemical companies.
>
> Today, there are no more than 15 independent carpet yarn spinners and 10 of them would have almost 90% of the capacity.

You will thus see that a small business has been virtually squeezed out of this industry.

JUSTICE'S DOUBLE STANDARD

by

Timothy H. Fine
Acting Chairman
Task Force on Antitrust & Regulation
Small Business Council of Democratic National Committee

William F. Baxter is Chief of the Antitrust Division of the United States Department of Justice. He is charged with the overall responsibility for enforcement of the nation's antitrust laws. Since taking office a little over one year ago, Mr. Baxter has indicated his fundamental disagreement with many of the well-established tenets of the antitrust laws. However, instead of approaching Congress about amending the antitrust laws to coincide with his views, Mr. Baxter has chosen not to enforce those antitrust laws which he does not agree with - a position which certainly appears counter to the "law and order" position of Mr. Baxter's boss, Attorney General William French Smith, as well as the often-stated principle that we are a nation of laws, not of men.

The antitrust laws are written in broad language - like the U.S. Constitution - in order to meet the needs of an ever-changing economy. Within the context of such broad language, there has developed certain trade practices which the Courts have over the years concluded to be so anticompetitive to be unlawful in and of themselves - referred to as per se vioations. As recently as June 18th of this year, the Supreme Court of the United States indicated that four such per se offenses were price fixing, division of markets, group boycotts and tying arrangements. Notwithstanding such pronouncements from the highest court in the land, Mr. Baxter has indicated that he does not intend to conduct his office in accordance with such pronouncements.

In March of this year, Mr. Baxter authorized the dropping of the Government's case against Mercedes-Benz of North America - a case originally brought in 1979 by Mr. Baxter's predecessor, Sanford M. Litvack. There, Mercedes-Benz of North America was charged with engaging in the *per se* offense of a tying arrangement: requiring its dealers to purchase repair parts at a higher cost from Mercedes-Benz as a condition of buying the company's cars. The effect of such a tying arrangement is to preclude the Mercedes-Benz car dealers from purchasing comparable repair parts from other suppliers at lower prices. The Federal District Court had, prior to the dismissal of the case, ruled in favor of the Government on several of the issues in the case. Notwithstanding such favorable rulings and the law of the land that tying arrangements are inherently anticompetitive, Mr. Baxter chose to dismiss the case because his school of economics believes that tying arrangements are not anticompetitive. The adverse effect of Mr. Baxter's thinking on small businesses trying to compete with the automobile manufacturers in the replacement parts market will be devasting!

More recently, in an interview with a staff writer of The Washington Post newspaper (8/13/82), Mr. Baxter stated that except in special cases the Antitrust Division will not prosecute manufacturers that fix the resale prices charged by others for their products - a practice known as resale price maintenance or vertical price fixing. This trade practice too has been condemned as per se illegal by the Supreme Court: originally in 1911 in the Dr. Miles Medical Co. case and lately in 1980 in the Midcal Aluminum case. An exception to the ban on resale price maintenance existed during the period of 1937 to 1975 for products that were fair traded. In 1975, Congress repealed the fair trade exception after evidence was presented that the fair trade laws were costing consumers an additional $2 billion a year.

Mr. Baxter acknowledges that resale price maintenance is illegal and may result in higher costs to consumers. But, he justifies not enforcing the ban on resale price maintenance upon his school of economics which views such vertical price fixing as not anticompetitive; rather, Mr. Baxter argues, fixing the prices at which technologically complex goods are resold to the public will encourage their production since those retailers that handle these complex products will have the necessary sales and profits (generated by the higher fixed resale prices) to provide various support services required by the manufacturers. If Mr. Baxter's argument is correct, then the main beneficiaries will no doubt be the Japanese manufacturers of cameras, stereos, televisions, video recorders, calculators and home computers - who eagerly fair traded these and other products prior to 1975. The detrimental effect of resale price maintenance on small business is that it permits the supplier to dictate their profits, since the small businessperson no longer has any price freedom.

Mr. Baxter aligns himself with a particular, limited and quite narrow tradition in academic economics - the Chicago school of economics theory. These theorists use static price theory to resolve the policy issues they address and also challenge the validity of all antitrust goals save efficiency. Based upon a slavish belief in the correctness of his economic theory, the Antitrust Division under Mr. Baxter has abandoned almost all vertical antitrust cases (such as those involving tying arrangements and resale price maintenance), even though the law still holds these practices to be illegal and felonies.

As pointed out by Professor Lawrence A. Sullivan, author of the text, Antitrust, widely cited in antitrust court decisions and used extensively in the teaching of antitrust law in the law schools, there are significant deficiencies in the Chicago theory and "[a]ny claim that Chicago analysts hold the butterfly of truth secure in the net is sheer hubris." Professor Sullivan emphasizes that the courts "should refuse to surrender to any group of theorists the basic value judgments that should be made by Congress and, with deliberation, by the courts themselves."

However, the issue here is not the correctness of the Chicago school of economics theory; rather, the issue is far more profound - the actions of an official sworn to uphold the laws of the land placing his economic theory ahead of the law as laid down by Congress and interpreted by the highest court. The effect of Mr. Baxter's actions is to create a double standard of justice: A double standard that spells disaster for America's small businesspersons.

Senator RUDMAN. Our next witness will be Mr. Eliot Janeway.

Mr. Janeway, welcome to our hearing again. You have been before us before. We appreciate very much your coming down here to testify today.

Because of the length of time we have already consumed, your entire statement will be placed in the record. If you would like to summarize it in any way, we would appreciate that. You may proceed.

STATEMENT OF ELIOT JANEWAY, PRESIDENT, JANEWAY PUBLISHING AND RESEARCH CORP.

Mr. **JANEWAY**. Mr. Chairman, it is a privilege, and I am happy to submit my statement and submit myself to any questions you may have in mind.

In the interest of time and also in an effort to come to the point, I would like to read the last paragraph of my statement:

"By way of a concluding and conclusive illustration"—this is responsive to the policy statement put out by the Federal Trade Commission, which speaks of, if I can find it—give me a half a second.

Senator RUDMAN. Take your time, Mr. Janeway.

Mr. **JANEWAY**. It speaks of decisions which have been made as decisions which represent the economic use of capital. Senator Gorton, you said, and I certainly subscribe to this view of yours, that in our society we pay a price, we often pay a price, for inefficiency in the interest of certain social values.

In my statement, I recall that the late Mr. Justice Douglas told me that the cornerstone on which our public policy is based, exactly as you have just said, calls for us to accept a price in admitted inefficiency as the cost of preserving human and social values to which our society is committed.

Great though my respect for Mr. Justice Douglas and his legacy is, especially for his knowledge of corporate finance, nevertheless, I find myself thinking that he conceded too much. The antitrust authorities have given us the airy assurance that decisions made by Fortune 500 conglomerates—and that is a redundancy because all of them are conglomerates—guaranteed the economic use of capital. This refers to the statement by the Federal Trade Commission.

I know of no economic contract in our complicated society providing that decisions made by larger manufacturers will be profitable to them and productive for our economy. Quite the contrary. This fixed premise of our starry-eyed inspectors general clashes with the undeniable experience documented by the disaster in our economy.

The Secretary of the Treasury and the Commissioner of Internal Revenue are in a position to give this committee the grim count on the billions of lost revenue resulting from tax losses taken and refunds claimed by corporations which, by their own free filings, have acknowledged that their investment decisions made no sense and cost no end of dollars.

The fact of a business decision gives no assurance of a gain for the economy and against the loss for the decisionmaker. When corporations assert prerogatives that cannibalize their suppliers, their dealers, and therefore their bankers, they challenge the custodians of our antitrust laws to do their duty by giving evenhanded consideration to the complaints of the victims and enforcing the laws that protect today's fat cats from turning themselves into squealing mice and taking the rest of us along with them.

By way of a concluding and conclusive illustration, let me cite the case of our best-financed major corporation, which, as I believe, also happens to enjoy the benefit of having the shrewdest financial management. Within recent memory, it has written off not a king's, but a sheik's ransom in losses taken, admitting a long series of "unsound investments leading to the inefficient use of capital," to quote the Federal Trade Commission policy statement on horizontal mergers.

At the same time, it, along with the other major oil companies, is insisting on cash settlement in a matter of days for truckloads delivered, while interest on idled capital remains a major profit center for them, and petroleum products are priced at the retail level as if more refineries were needed and no refineries or gas stations were being shut down. How economic is this use of capital?

I cite that as a specific case of maligned neglect on the part of the authorities.

I would like to make one other specific comment based on your cross examination of Mr. Baxter. He fell back on the position—I had no knowledge that he would—that many complaints are best left to the initiatives and resources of those alleging damage. Well, that is mockery under today's conditions.

The victims in these cases are, again and again, smaller outfits having the devil's own time meeting back interest payments and back local property tax payments. They cannot undertake litigation; it is preposterous.

I have many more things on my mind, but I will be happy to respond to questions.

[The prepared statement of Mr. Janeway follows:]

STATEMENT OF ELIOT JANEWAY

Mr. Chairman, it is with a deep sense of professional gratification and personal dedication that I come here for the third time within the past year, this time in response to your invitation to address the question of Federal Anti-Trust Enforcement and Small Business. Let me begin by striking a cautionary note on the subject of the promised recovery. I see no evidence that it has begun.

On the contrary, I see a great deal of evidence of further deterioration. My co-worker, the well-known sampler of consumer behavior and expectation, Albert Sindlinger, reports a startling, indeed an alarming divergence of confidence between consumers who are stockholders and consumers who are not: Among stockholders, 67 percent anticipate the performance of the economy with confidence; among non-stockholders, a scant 15 percent—a record divergence.

I hasten to add that, in our joint explorations from our different approaches, I have consistently found Sindlinger's highly sophisticated samplings of non-stockholder confidence in the performance of the economy reliable and his samplings of stockholder confidence extremely unreliable. As to the conspicuous switch in stance on the part of the Federal Reserve Board, I believe that the record will show that consideration for the condition of the world banking system, and its backlash upon our own, shocked the Fed into assigning top priority—hopefully in timely fashion—to the responsibility Congress gave it in the Federal Reserve Act of 1913 to serve as "the lender of last resort." Under present credit market conditions, this is clearly a more practical mission than the Quixotic one of controlling the money supply, which it is just as clearly unable to count. I know of no case in the record books of a recovery in business activity, and/or employment, and/or business investment and/or consumer spending when trouble in the banking system is a clear and present danger. It is my judgment, therefore, that we will do better to examine the obstacles to recovery before we get ahead of ourselves, as administration spokesmen are doing, by assuming that it is already off and running.

In my two previous appearances before this Committee, I suggested the urgency of focusing our scrutiny on the toll taken on small business by the collapse in the economy. If this description of the present disturbance seems extreme, it was Irving Kristol, the well-known advisor to the Reagan White House, who gave this description of it in one of his Wall Street Journal articles in late 1981, when the emergency in the economy was still in a preliminary phase. In my view of the structure of the economy, small business is not a poor relative or an object of charity to be treated with condescension. Big business cannot function unless small business is vibrant. The old guip about America's role in the world applies to the role of small business in the American economy: When it gets a cold, big business gets pneumonia. Mr. Chairman, small business has pneumonia, and the government—with a powerful lead from its anti-trust arms—is fresh out of anti-biotics.

This is no mere sentimental generalization on my part. It rests on a basic function of American economic life. As I emphasized in my first two appearances here, small business provides big business with its arteries of distribution and supply. Plants, by definition, cannot move goods, nor can they store goods at economic points of distribution to ultimate consumers. Only small businesses can perform this vital distribution function.

General Motors, in its great days, recognized this fact of commercial life with explicit practicality. Its lead dog was Chevrolet. Under the Sloane regime, Chevrolet was relied on to pay all of General Motors' overhead; so that every dollar taken in on the rest of the line was counted as pure profit. How did it back up the Chevrolet success story? By selling the Chevrolet owner on the idea that a Chevrolet dealer could always be trusted to be there with a good, solid trade-in offer. How did GM enable its Chevrolet dealers to make good on this promise? By giving them a 40 percent mark-up and inviting them to use it at their discretion and on their bankroll to keep new models moving. In the days before American cars were priced out of even Detroit, this was good business, but more important to the problem confronting us today, it was sound business. What does it assume? A solid and liquid dealer organization—self-financing. What was the gold prize in those bygone years for a worthy GM executive upon retirement? The opportunity to acquire a Cadillac franchise. No one is forming a line to buy one today.

The decline of the American economy is measured by the shrinkage of its dealer franchises. When America's corps of dealers is stricken with pneumonia, small business is in the terminal ward, taking big business with it. Another instructive glance back to the great days of the auto industry, when Henry Ford was bringing cheap, do-it-yourself transportation to the mass market. He operated without a bookkeeping system. Nevertheless, he reckoned that he lost $12 on every new Flivver and made it back nickeling and diming his customers for spare parts. No one could fairly fault him for that because he was peddling a bargain in the first place; and in the second, because his dealers participated in it; and, not least, he really was the manufacturer of his simple, new motorized gadget.

Today, by contrast, manufacturers of just about everything, and certainly automobiles, are increasingly tending to become assemblers who buy the components of their end products from the small businesses who do their manufacturing for them. It's well known that the terms of competition in bidding for original equipment call for manufacturers to get on to production schedules at a loss, and to make it back on the sale of replacement parts through dealers to customers. This goes for producer durables as well as for consumer durables.

It's axiomatic that the suppliers of manufactured components are smaller businesses than the corporate giants assembling the end products and controlling their distribution. If the assemblers of the end products, who already exercise a stranglehold on their suppliers, were to enjoy undisputed legalized control over the distribution of the following spare parts on which their suppliers depend for survival, a wipeout for the manufacturers of components would be guaranteed. So would a new take off in the inflation of hard goods prices at a rate guaranteed to leave all of us gasping and complaining that the 1981 spiral was just a trial run for learning how to dance the Brazilian two-step.

As I emphasized here before, the defense establishment and its prime contractors are particularly vulnerable to casualties at the subcontractor and supplier level. Senator Nunn has repeatedly criticized the false economies in squeezing provisions for small parts out of weapons procurement.

In reading recent pronouncements from the chief policy-making antitrust officials in this Administration, Mr. Chairman, I find myself not merely troubled but positively alarmed by a radical strain of ideological dogmatism that runs counter to our structure of Constitutional procedures and of statutory precepts. Mr. Justice Holmes, whose opinions can hardly be dismissed as random rantings, warned his colleagues on the Supreme Court in one of his celebrated dissents, that it is the duty of the Court to work within the guidelines set for it by the Constitution and not to usurp the role of Congress in legislating the principles of Herbert Spencer, who exhorted Victorian England to treat human beings in the same savage way that Sparta treated babies too weak to be trained for war and that Darwin observed animals treated each other in the jungle.

Holmes reminded the Court that "a Constitution is not intended to embody a particular economic theory." Substitute the editorials of *The Wall Street Journal* for Spencer, Mr. Chairman, and the reach of Holmes' wisdom puts the antitrust authorities of this Administration on notice to do the job Congress has empowered, and indeed instructed, them to do instead of denying the need of trying. If the Constitution is good enough to give the Supreme Court its marching orders, it is good enough to give an assistant attorney general and a quasi-judicial agency theirs.

The legacy of Brandeis and Douglas guide us on this score as well. Brandeis argued in his curse of bigness that the small proprietor working with his own money, and on trial for his financial life to know his business, can always be trusted to outperform an impersonally managed corporate giant; provided that the government does not stack the cards in favor of antitrust abuses and against individualistic incentives. Douglas told me that the cornerstone on which our public policy is based calls for us to accept a price in admitted inefficiency as the cost of preserving human and social values to which our society is committed.

I am prompted to conclude on this philosophical note, because we have learned again and again to our cost, the policies that we follow determine the practicality of the decisions we make. The antitrust authorities have given us the airy assurance that decisions made by Fortune 500 conglomerates—a redundancy, Mr. Chairman—guarantee the use of capital. But I know of no economic contract in our complicated society providing that decisions made by larger manufacturers will be profitable to them and productive for our economy. Quite the contrary, this fixed premise of our starry-eyed inspector generals clashes with the undeniable experience documented by the disaster in our economy. The Secretary of the Treasury and the Commissioner of Internal Revenue are in a position to give this Committee the grim count on the billions of lost revenue resulting from tax losses taken and refunds claimed by corporations, which by their own free filings, have acknowledged that their investment decisions made no sense and cost no end of dollars. The face of a business decision gives no assurance of a gain for the economy and against a loss for the decisionmaker. When corporations assert prerogatives that cannibalize their suppliers, their dealers and, therefore, their bankers, they challenge the custodians of our antitrust laws to do their duty by giving even-handed consideration to the complaints of the victims and enforcing the laws that protect today's fat cats from turning themselves into squealing mice and taking the rest of us along with them.

By way of a concluding and conclusive illustration, let me cite the case of our best-financed major corporation, which, as I believe, also happens to enjoy the benefit of having the shrewdest financial management. Within recent memory it has written off not a king's, but a sheik's ransom in losses taken, admitting a long series of "unsound investments (leading) to the inefficient use of capital"—to quote the Federal Trade Commission policy statement on horizontal mergers. At the same time, it, along with the other major oil companies, are insisting on cash settlement in a matter of days for truckloads delivered, while interest on idled capital remains a major profit center for them and petroleum products are priced at the retail level, as if more refineries were needed and no refineries were being shut down. How uneconomic is this use of capital?

I appreciate your consideration of my views and observations.

Senator RUDMAN. Well, maybe we will develop a few in questions. I believe you were in the room when Mr. Baxter responded to my question about the *Mercedes* case, the tying case, in which they essentially dropped that case, and I asked him a hypothetical involving Ford. It is strictly hypothetical. Or it could have been Chevrolet.

Mr. JANEWAY. It is in my statement.

Senator RUDMAN. I am going to read that. I just want to ask you this question. Do you agree with me that that kind of tying arrangement is damaging to consumers and that essentially it throttles small business and results in a lessening of competition?

Mr. **Janeway**. It also wrecks big business, so that my agreement with you goes further, without indulging.

General Motors, in its great days, recognized this fact of commercial life with explicit practicality; namely, that plants don't sell goods. Its lead dog was Chevrolet. Under the Sloane regime, Chevrolet was relied on to pay all of General Motors' overhead, so that every dollar taken in on the rest of the line was counted as pure profit, as we say, incremental profit.

How did General Motors back up the Chevrolet success story? By selling the Chevrolet owner on the idea that a Chevrolet dealer could always be trusted to be there with a good, solid trade-in offer. How did GM enable its Chevrolet dealers to make good on this promise? By giving them a 40 percent markup and inviting them to use it at their discretion and on their bankroll to keep new models moving.

In the days before American cars were priced out of even Detroit, this was good business, but more important to the problem confronting us today, it was sound business. What does it assume? A solid and liquid dealer organization, self-financing. What was the gold prize in those bygone years for a worthy GM executive upon retirement? The opportunity to acquire a Cadillac franchise. No one is forming a line to buy one today. [Laughter.]

If you look at the mortality rate of dealers, in all that produce a durable line, you will see all you need to know about the disaster in the economy, the splintering of the base, as Senator Nunn said, and the bankruptcy, the choking up of our apparatus not only of distribution but of supply.

Now, my statement also goes back to Henry Ford, who never had a bookkeeper. Forget computers; no bookkeeper. But on the backs of his envelopes, he always figured that it cost—I think this is more than legend—$12 a car in loss at the factory gate to sell a Flivver. How did he make it back? Spare parts.

When Secretary Simon was here in a previous administration, he said the way to defend ourselves and bargain hard with the oil producers who import to us is get a grab on the spare parts that we ship to them behind the equipment they buy, weapons and otherwise.

Well, the key to the problem is in ongoing spare parts. That was true even when they worked. [Laughter.]

It is more true now that they don't. If you do not induce and encourage competition at the spare parts levels, you will find that manufacturers—and I don't refer to Ford or General Motors when I speak of the manufacturers. The manufacturers are more likely to be little fellows in your State, Senator Rudman.

Senator **Rudman**. I agree with you.

Mr. **Janeway**. Now, the majors, the Fortune 500 conglomerates, are increasingly assemblers. That certainly goes, Senator Gorton, for a great organization whose name is synonymous with your State, Boeing. The people who do the manufacturing buy the business by taking a loss to get their original equipment.

Now, if you don't have a free market in parts, working through a vibrant dealer organization, you are, first of all, going to lose your manufacturing sources to the big-name assemblers. You are then going to lose your manufacturers. We know that there is one sure consequence that occurs when Braniff gets "Braniffed." American Airlines raises fares.

So what you are reading or forecasting with your own desk Apple every time you look at the figures on bankruptcies, especially of dealers, is a breathtaking, blood-curdling rate of inflation in the years not too far ahead. The number of entries in industry after industry has shrunken in an alarming way.

Senator RUDMAN. Senator Nunn, do you have questions for Mr. Janeway?

Senator NUNN. It just seems to me that Congress has a role to play here when we have a period of great recession and multiple small business problems, coupled with a great reluctance on the part of big business and others to invest in new plants and new equipment. It seems to me that there is a climate that almost dictates merger and acquisition rather than new investment. Now is the time when, even if we are going to review the last 25 years of antitrust policies, and even if there are going to be changes made, and even if some of the present laws don't make much sense, it is a time for caution in this climate in moving toward significant antitrust changes.

It is just an observation that it may be more dangerous now to make those antitrust changes than it would be in some more benign climate. Do you see that, from an economical point of view?

Mr. JANEWAY. Well, I think that the bidding contests are part of the shrinkage process. In the discussion you had with Mr. Baxter, in the Bendix case, I think there was one consideration that was omitted. In response to your question, Senator Gorton, Mr. Baxter went on about rational decisions, and so forth and so on, as if economic man had never needed a psychoanalyst. [Laughter.]

The fact is, however, that there is a very, very rational motivation, a motivation so rational that it is hysterical, on the part of all cash-rich corporations subject to shrinkage to go out and buy anything, beginning with the first garbage truck around the corner, to get rid of that cash, because the potential predator doesn't want to know about the productivity of the machine tools or the labor contracts or whatever; the potential bidder wants to get cash for nothing.

The management—I don't mean to be personal about it—but the management, looking for anything to buy, wants a cemetery into which to park that cash before the predator comes along and grabs it, and this at a time when, as the very shrewd head of Teledyne, Mr. Singleton, has said, most corporations paying dividends are not only borrowing the interest to pay on the debt they owe, but they are also borrowing the money to pay their dividends.

One of the reasons for the difficulty we are in, and this is a paradox but it is a set of facts needing to be faced, the corporate establishment, and certainly the banking establishment, a bank which I don't want to name because it is the largest one in America. [Laughter.]

It put a statement out on the tape yesterday after Bolivia paid a couple of million dollars saying that the Bank of Whatchamacallit is not broke. Well, now, in a situation characterized by galloping illiquidity in the corporate sector, which certainly has something to do with the state of the deficit—refunds, tax refunds, this fiscal year, ending this month, are running neck and neck with Mr. Stockman's next-to-last projection on the deficit, about $112 billion as I figure it.

Now, you have this corporate illiquidity, you have the predators out looking for outfits from whom they can get cash at a discount, and you have this deficit. Again, in terms of you and Justice Douglas, you have the presumption that we are paying a price in inefficiency for certain restraints and guidelines, rules, and so forth. I cannot think of many records studded with more inefficiencies than some of these so-called economic uses of capital.

Management, wanting to preserve its prerogatives, will make an economic use of capital and a rational decision, and so forth, in terms of its own expense account, overpaying for who knows what. The records of these acquisitions are preposterous.

Now, I would think that the tax laws, in response to Senator Nunn's question, are in need of some revision to put acquisitions under some sort of punitive retrospective study, I mean to put the acquiring companies on strict and stern notice to make what they are doing pay off for themselves and for their stockholders, instead of merely saying, well, it was a windfall for the selling stockholders and we broke even.

Senator RUDMAN. Senator Gorton?

Senator GORTON. Would you speak just briefly, Mr. Janeway, on the somewhat broader subject of economic recovery, the fact of the sharp increase in the stock market which, historically, at least, has been an indicator of recovery, and what your views are on those subjects?

Mr. JANEWAY. I am glad, as the fellow said, that you asked that question.

I see no evidence of recovery. I know of no case in the record books of a recovery in business activity and/or employment and/or business investment and/or consumer spending when trouble in the banking system is a clear and present danger.

These bank managements are going to come home from Toronto with one unanimous resolve: Make no new loans. Hang up the phone when a big city bank calls you and offers you a participation.

Senator Nunn, a major institution in Atlanta got into a sparring contest in the Constitution, I think it was, with a spokesman—a spokesman did with the press, with the Constitution—on the subject of how significant a $100 million loss taken in the Mexican affair was for it, and the bank spokesman said, "Well, it really isn't much compared to our total loan portfolio, but it was two-thirds of the bank's capital."

See, now, I know of no case in which you get recoveries—and in my judgment, you have not started one yet; you are just picking daisies talking about one—I don't mean you, Senator Gorton—but I don't think, if you had a beginning towards one, it would get anywhere in the present state of, (A) anxiety on the part of bank management, and (B) actual capital touchiness.

In my statement, I refer to studies by a well respected, well known opinion sampler with whom I work in a collaborative way, and he reports—this is last Friday—he reports a startling, indeed an alarming, divergence of confidence between consumers who are stockholders and consumers who are not.

Sindlinger finds that 67 percent of stockholders anticipate the performance of the economy with confidence; among nonstockholders, a scant 15 percent. He tells me that he has never found such a divergence. No problems among the universe of stockholders; disaster forever among those not owning stocks.

I hasten to add that in our joint explorations from our different approaches, I have consistently found Sindlinger's highly sophisticated computer work sampling nonstockholder confidence in the performance of the economy reliable, and his sampling of stockholder confidence extremely unreliable. That is, the hotshots, the stockholders, are always wrong about the economy, and six-pack Joe is invariably wrong; he doesn't know a stock from a $2 ticket at the racetrack.

Senator GORTON. Invariably right?

Mr. JANEWAY. Invariably right. I misspoke. I apologize.

Now, as to what happened in the stock market, my mind goes back again to your colloquy with Mr. Baxter and his response. He spoke of all these shrewd and sophisticated, and I think he may even have gone to the point of saying wise, financiers on Wall Street.

One direct reason for the blowoff, the explosion, as in my judgment it is, if it is still going on, is that all the insiders, the professionals, the fellows with the computers and the inside dope, they were all short the day it started. It was a record short squeeze. I have never seen one like this. And when you have a short interest that is large and professional in a market that has not developed much volume, which in my judgment is the key to market action, the market always goes up until the last short has been strangled.

Now, I think that is what has been going on. If you think of a chart in which you have, as if it were a cardiogram, in which you have a spike, I think you have the picture of the market. It is a spike. Napoleon said about armies, "An army can do anything with a bayonet except sit on it." [Laughter.]

The stock market can do anything with a spike except sit on it. The key to the market will be not prices but volume. It got to, I think, 132 million shares on that last big day. It is now running at about only 75 million shares.

The president of the New York Stock Exchange, who knows his computers, said he thought the market could handle 200 million shares a day. I don't think it will get quite that opportunity before this is over. I think it will go to 150 million shares. I think that will be it, and you will then see—I don't know whether it will come on October 28—you will see the ghosts of 1929 marching down Wall Street.

Further, as an answer to your question, I suggest this: If the bullish prognosis, if it were in order to take credit for what has been happening to the stock market to prove prudent, one would then have to explain the simultaneous and even more startling and impressive recovery in the price of gold.

In my judgment, gold has no value whatever, which explains why its price is free to go up, contrary to these undervalued stocks that we see, which the predators go after. Gold swings on a seesaw against whatever it is that may or may not be going on in this town, in this economy.

Secretary Regan, if you remember, said at the outset of his term, "I would like to see gold at $350." Well, the outside world thought the administration was doing so fine—I vividly recall the conversation that you and I had, Senator Rudman and I had, when I was here in December—doing so fine that it really broke the price of gold. While the market was doing what the market was doing, gold starting—let's be a sport and call that 15 percent for the Dow average—gold started on the road back at $270-something. It was $505 in Hong Kong this morning. Again be a sport and call it $500; $300 to $500. Where I come from, that is two-thirds. It has really outrun the stock market.

That is really not a pleasant foreboding. Gold never does well when things go well. It is nothing but a counter of trouble, so that when gold gets on the jet runway like that, it is telling you, mind your P's and Q's and batten down the hatches, and not to be thinking any recovery is coming, but to worry about whether the Federal Reserve Board is going to be a lender of last resort, which is what it was put there to do in the act of 1913; it was not put there to control money supply. It can't count! [Laughter.]

Senator **Rudman**. Mr. Janeway, we want to thank you very much for again joining us. You are one of the few people that appears before this committee or any committee that can bring very bad news and still make one feel good.

Mr. **Janeway**. That is because I am an optimist. I think we could get out of this in 48 hours if you fellows were being listened to a little more studiously.

Senator **Rudman**. Thank you very much, Mr. Janeway.

Mr. **Janeway**. Thank you.

Senator **Rudman**. Mr. Ed Walter.

Mr. Walter, thank you very much for being here. We will have your complete statement for the record. If you could, in your own words, summarize for us your testimony, I would appreciate it, because the hearing has gone a bit beyond what we had hoped it would.

Mr. **Walter**. I will try to do just that.

Senator **Rudman**. If you would identify yourself and where you are from and your background, that would be helpful.

STATEMENT OF EDWARD S. WALTER, PRESIDENT, COMPUMART CORP.

Mr. **Walter**. First of all, I am honored to have this opportunity. I will briefly go through and highlight a few of the points, since it is obvious that I came here to discuss my company and its problems with Apple, and obviously those of you on this committee understand a lot about the problem. You probably will be hearing more about it in the next year.

My company is a supplier of small computer systems to industrial and technical end users. It was established in 1971. I became the president in 1979.

We began selling to individual scientists, educators, and hobbyists, and we serve today approximately 17,000 customers. We have been the choice of many of the major companies including major computer companies, auto companies, and the Fortune 1,000, as well as most of the schools and universities.

The key point, I believe, that is going to be talked about in the future relative to mail order is that our customers who buy computers from us do not require and in fact do not prefer face-to-face meetings to place or to complete a purchase. They do require a competent, knowledgeable sales and engineering staff, prompt and diligent service, and a flexibility to solve changing or complex problems with customer configurations.

You have asked me to testify on the impact of antitrust enforcement on a small business. In my mind, there is no question but that business needs the opportunity to compete, and that opportunity must be protected by enforcement of the antitrust laws.

Small business is particularly vulnerable to abuses of these laws. This is so because of the constant need for flexibility in reacting to economic and market conditions. As the economy and market change, price distribution, sales methodology, advertising, and a host of other parameters must be constantly juggled to achieve business goals.

Small businesses, like large ones, have bills to pay, salaries to meet, and agreements to honor, but often lack the financial options of their larger counterparts. If inventory builds up when business is in a down period, a quick sale at lower prices, even at a loss, might be in order to raise needed cash.

Faced with dictates of price, territory, or other restrictions by their suppliers, this option might not be available.

The second point I would like to make is that it is my belief that a small business ought to be able to operate with confidence, so long as the market is satisfied with the quality of its service and the supplier's image is enhanced through proper representation.

Reaching a customer and responsibly providing him with satisfactory products and services should be the primary task in a competitive market system. If a supplier chooses to deal with an independent dealer for such a service, that dealer should have some confidence that the rules under which he will operate are fair and will not be arbitrarily changed. Our business is based upon the knowledge that there are such protections available.

In line with the above opinions, the third comment involves the independent nature of the business. If franchisers want to exert significant control over how their products get sold, then they ought to open their own stores or dealerships, staffed with their own employees. The independent dealer is supposed to be just that, independent, and subject to market forces, not the supplier's whim.

My company's experiences, which I won't go into for the sake of time, involving retail price maintenance are indicative of a giant flexing its muscles, counter to the opinions that I have expressed and I believe, which are a detriment to the customers, particularly to my customers.

We share this experience, my company's experience with Apple—we believe it is responsive to the committee's request—for an example of what can happen to a small business as a result of less-than-vigorous enforcement of the antitrust laws.

I personally have no doubt that Apple's cutoff of mail order and phone sales merely is merely a response to complaints from other Apple retailers who want higher margins for Apple sales. To me it is an example of illegal retail price maintenance, with the result that the customers are going to pay more for the products, and the services provided are less than they may want and need.

My certainty on this issue is, however, subordinate to the business sentiments that I expressed at the opening of my statement. My company has become an ideological victim to a philosophy of a dominant supplier who boasts an independent dealer network in the face of vague and unwise controls; who cuts off dealers of long and good standing without warning and introduces controls which provide that every customer pay for the same services, whether they are needed or not.

I think I would just like to add something that will come across in reading the entire statement, and that is that my business was not set up to sell computers to people in the home; it was set up to sell to industry. Most of the arguments that are used by Apple are geared to the home user and leave out the services provided to industry.

When we were terminated, we were forced to lay off employees, close a division that was in Ann Arbor, Mich.; and there was a cut in my company of roughly 40 percent of the staff, which, for a company doing $10 million in sales, represented 15 people. We also had some people—we had, in particular, one salesman that we felt, on the phones, was an expert with the Apple computer, who is handicapped, who was doing an excellent job. Customers appreciated the efforts. All of this basically had to be wiped out within a month because we were terminated in a letter that came on a Friday afternoon that said, "From now on, you can't buy any more computers." There was no warning in it whatsoever.

I guess that will be the end of my prepared statement.

[The prepared statement of Mr. Walter follows:]

STATEMENT OF EDWARD S. WALTER, PRESIDENT, COMPUMART CORPORATION, BEFORE THE SENATE COMMITTEE ON SMALL BUSINESS AND THE SENATE APPROPRIATIONS SUBCOMMITTEE ON STATE, JUSTICE, COMMERCE, THE JUDICIARY AND RELATED AGENCIES

SEPTEMBER 9, 1982

Mr. Chairman and Members of the Joint Committee:

I am Edward S. Walter. I am President of the Compumart Corporation, which is headquartered in Cambridge, Massachusetts. I am honored to have this opportunity to present my views before your Committee, and very much appreciate the Committee's interest in hearing them.

Compumart is a supplier of small computer systems to industrial and technical end users. Our company was established in 1971 and I became its President in 1979. In 1976 we pioneered the sale of microcomputers, the precursors of today's personal computers. We began by selling to individual scientists, educators, and hobbyists. Today we serve approximately 17,000 customers in science, industry and education. We have been the choice of the major auto companies, the major oil companies, and even the two major computer companies. Our Cambridge Digital Systems Division has become a leading supplier of many computer-based development systems.

Our customers usually do not require, and in fact do not prefer, face to face meetings to place or to complete a purchase. They do require a competent and knowledgeable sales and engineering staff, prompt and diligent service, and a flexibility to solve changing or complex problems with custom configurations. In responding to this demand, we have created what I believe is a unique organization to solve our customers' needs. The result is that Compumart has been quite successful. In 1981 our sales approached $10,000,000.

You have asked me to testify on the impact of antitrust enforcement on a small business. In my mind there is no question but that business needs the opportunity to compete and that opportunity must be protected by enforcement of the antitrust laws.

Small business is particularly vulnerable to abuses of these laws. This is so because of the constant need for flexibility in reacting to economic and market conditions. As the economy and market change, price, distribution, sales methodology, advertising, and a host of other parameters must be constantly juggled to achieve business goals. Small businesses like large ones have bills to pay, salaries to meet, and agreements to honor, but often lack the financial options of their larger counterparts. If inventory builds up when business is in a down period, a quick sale at lower prices, even at a loss, might be in order to raise needed cash. Faced with dictates of price, territory, or other restrictions by their suppliers, this option might not be available.

Second, a small business ought to be able to operate with confidence so long as a market is satisfied with the quality of its service and the suppliers image is enhanced through proper representation. Reaching a customer and responsibly providing him with satisfactory products and services should be the primary task in a competitive market system. If a supplier chooses to deal with an independent dealer for such a service, that dealer should have some confidence that the rules under which he will operate are fair and will not be arbitrarily changed. Our business is based upon the knowledge that there are such protections available.

In line with the above opinions, a third comment involves the independent nature of the business. If franchisors want to exert significant control over how their products get sold, they ought to open their own stores or dealerships staffed with their own employees. The independent dealer is supposed to be just that - independent and subject to market forces, not the supplier's whim.

My company's experiences with Apple Computer Corporation involving retail price maintenance are indicative of a giant flexing its muscles counter to the opinions expressed above and, I believe, to the detriment of the customer. We share our experience with Apple as responsive to the Committee's request for an example of what can happen to a small business as a result of less than vigorous enforcement of the antitrust laws.

Apple Computer has been a phenomenon in the business world. In less than five years this startup company has produced close to a billion dollars in annualized sales, excellent profitability, and a leadership position in the personal computer marketplace. Compumart was one of the early dealers for Apple and in those five years its personal computer division grew to $5 million, 70% of which were Apple or based on the use of Apple computer systems. Compumart's sales are primarily to the industrial and educational end user. In the last three years the dealership accounted for sales of approximately 3,000 Apple Computer systems and peripheral products to over 10,000 customers. This business was conducted on a national basis from Cambridge, Massachusetts, and on a regional basis from Ann Arbor, Michigan. The relationship with Apple was excellent; in fact, Apple was utilized by us as a prime reference for trade and credit inquiries from other suppliers.

In November of 1981 my company received from Apple an amendment to the current dealer agreements then in effect at both our Cambridge and Ann Arbor locations. The amendment forbade sales of Apple supplied products by means of telephone or mail and specifically required that the customer have face to face contact with the seller for each and every sale. This requirement applied for all Apple products whether sold to purchasing agents, scientists, engineers, government agencies, or school children. No distinction was made as to education level, function within an organization, or services actually required for the sale. Since 80% of Compumart's business was to industrial and educational customers who customarily rely on the phone for centralized purchasing of industrial products, the effect of this amendment was to immediately cripple my business. The agreement was signed, however, under threat of immediate franchise termination and my management team set about to find a resolution to the dilemma.

A strategy was formulated at Compumart to insure adherance to the new Apple policy while still servicing existing customers. Our sales personnel were given a written script to screen callers as to whether face to face contact had previously occurred. Furthermore, our sales department was instructed to sell only to those callers who were properly screened. The script was even given to Apple and approved by the regional sales staff in Boston. Unknown to us, Apple had apparently begun a program of surveillance to enforce its new rules. In the end a trivial indiscretion by one of the sales staff turned out to be the immediate cause for a summary franchise cancellation by Apple. Apple's legal department informed us that they had successfully purchased a computer from us and the machine along with a transcript of the sales conversation were in their possession. As a result of the termination, all employees of Compumart involved with sales of personal computers had to be laid off, the Ann Arbor location was sold on a distressed basis, and customers began to be notified that we no longer carried Apple products.

One month later Apple offered an elaborate plan of reinstatement by which Apple would sue us for franchise violation to which we would freely admit culpability in court. A pre-stipulated judgement would have us admit to violation of the original dealer agreement and a promise to not recommit the same under court order and penalty of contempt of court. This method of reinstatement was so well worked out that our company was to be permitted to file the complaint, in effect, on behalf of Apple. On advice of counsel that this method of reinstatement was merely a ruse, an imposition on the courts, and coercion to enter into an illegal agreement, the offer in that form was not accepted. With that decision, one of the country's pioneering personal computer dealers was terminated.

I have no doubt that Apple's cutoff of mail order and phone sales was merely a response to complaints from other Apple retailers who wanted higher margins for Apple sales. This is an example of illegal retail price maintenance with the result that customers will pay more for Apple products and the services provided are less than they may want and need.

My certainty on the issue is, however, subordinate to the business sentiments expressed at the opening of this statement. My company became an idealogical victim to a philosophy of a dominant supplier who boasts an independent dealer network in the face of vague and unwise controls, cuts off dealers of long and good standing without warning, and introduces controls which provide that every customer pay for the same services whether they are needed or not.

I hope that these comments have been useful to the Committee and thank the Committee for its attention.

Senator RUDMAN. Mr. Walter, it is my understanding that your company did not have or did not believe it had the financial resources to hire counsel and to be part of this action that is brought against Apple. Is that correct?

Mr. WALTER. We evaluated it, and the expense in both management time and dollars was considered to be onerous.

Senator RUDMAN. Are you personally aware of any statements made by high-ranking officials of Apple, its president or its chairman, regarding antitrust laws?

Mr. WALTER. Yes, I am.

Senator RUDMAN. Would you tell us about those?

Mr. WALTER. Yes. There are two in particular that troubled me. We were offered reinstatement in a very interesting way, in essence a friendly lawsuit. We were asked to, in essence, sue ourselves on behalf of Apple, plead guilty, and have a stipulation of judgment that said we wouldn't do it again under penalty of contempt of court.

We refused to do that on advice of counsel for several reasons. They consider it an imposition on the courts, and also it would be an agreement to an illegal arrangement.

But during the time, I spent many hours with counsel Dave Koff at Apple, and he told me at the beginning that the Government was interested in intervening on behalf of Apple, which really shocked me. I have been in the computer business for 15 years. No major responsible company that I know of has ever tried to cutoff dealers that were doing a good job. I mean I know of none. I have dealt with IBM, Digital Equipment Corp., Data General, all of them. In fact, Digital is our other major line.

Here is a company that is in the forefront. They are the leader in the personal computer business. They are a phenomenal success. In 5 years, they are doing $1 billion in annual sales and making tremendous profits. They are cutting off a dealer who has sold 3,000 computers and did an excellent job. I think they had one complaint at a retail level on our business in the 4 years we have been selling Apples. We used to use them as a prime reference.

I was amazed that the Government was considering intervening on their behalf. I think——

Senator RUDMAN. And that was told to you by the counsel of Apple?

Mr. WALTER. David Koff, counsel for Apple.

Senator RUDMAN. And he told you that that was his information, that it was being considered? There was no assurance that that was going to happen, but essentially it was being considered.

Mr. WALTER. Right.

At a meeting, at a seminar, I had a chance to, face to face, talk with Steven Jobst, who is the chairman of the board of Apple, a very interesting fellow. He is 27 years old, and Time magazine says he is a billionaire. For a fellow that dropped out of school, I think that is remarkable, and it is a tribute to small business, the ability of small business to become big very quickly.

Aside from expressing feelings that Apple had pioneered in the small computer industry, he told me that we were going to pioneer in the antitrust field. My comment to him at the time was, I find it kind of unreasonable that a businessman would basically be wanting to do his business in courts, and we talked about it a little bit, and I think, primarily, because I felt a coldness in talking with him about our method of distribution.

I think, also, early on, a couple of years ago, the fellow that was in charge of their retail channel, a fellow named Mike Connor, called me up and said that they were considering taking action against mail order companies, in particular companies in California that were selling at low prices. They didn't do anything for 2 years, and I kept asking people, because I sell by mail order, and all of a sudden, I heard from the regional manager that they had hired an antitrust attorney. This was around October 1981.

Being in business, I don't have time to really follow what is going on in the antitrust world, but in preparation for this hearing, I saw some clippings in the New York Times and Washington Post that came out in April, May, and June, and it seems to me that something must have triggered—and I think Mr. Baxter's remarks might have been instrumental—might have triggered them to feel that now we can get away with it; this might be an opportunity.

Senator RUDMAN. Where is your corporation based?

Mr. WALTER. It is in Cambridge, Mass.

Senator RUDMAN. And you had other outlets around the country?

Mr. WALTER. In Michigan.

Senator RUDMAN. And have your gross sales plummetted since this?

Mr. WALTER. We went from $5 million to $10 million this year, and if we have the growth in the other division, we will be lucky to maintain what we did last year because we lost half of our business.

Senator RUDMAN. Thank you very much. Your testimony is very valuable to us.

Mr. WALTER. I appreciate the opportunity very much.

Senator RUDMAN. Your entire statement, which is most interesting, will be included in the record. Thank you very much, Mr. Walter.

Mr. WALTER. Thank you.

Senator RUDMAN. Mr. Mauro?

STATEMENT OF THOMAS A. MAURO, ON BEHALF OF THE SMALL BUSINESS LEGISLATIVE COUNCIL, ACCOMPANIED BY RANDOLPH J. SEIFERT, SMALL BUSINESS LEGISLATIVE COUNCIL

Mr. MAURO. Thank you, Senator.

I would like to, before I begin, introduce another member of our Antitrust Committee. As you know, I am here representing the Small Business Legislative Council, and I serve on the Antitrust Committee of that body. Randy Seifert is a fellow member of the Antitrust Committee. I am pleased to have him with me here today.

Senator RUDMAN. We would appreciate it if you could summarize your comments. They are very important for the record. The entire statement will be in record. We have run a bit over here, and I guess our schedules are kind of getting congested.

Mr. MAURO. Thank you, Senator. I will try to summarize the thrust of my testimony.

I would like to make just two points in summarizing our testimony. First, I would like to discuss briefly the argument of efficiency which is being made today in support of what the SBLC believes are de facto attempts to change the existing law in antitrust.

It seems to me that the efficiency arguments are an attempt to rewrite history. The antitrust laws were enacted to promote competition and opportunity for all. Thus, the antitrust laws embody political and social aspirations as well as economic goals. This fact cannot be escaped and should not be avoided.

Justice Brandeis, during his career, was deeply interested in antitrust and in the course of its enforcement. During his lifetime and his career, he championed the cause of antitrust and therefore, we think, small business.

In 1960, Prof. Milton Handler paraphrased his philosophy as follows, and if you will bear with me, I would like to read Professor Handler's comments into the record:

> A political democracy such as ours presupposed a higher degree of economic equality. Without such equality, democratic institutions would not survive. Bigness in business was a menace to government. It compelled bigness in government to counteract the influences which concentrated economic power could exert. It stimulated the formation of big unions. It condemned most Americans to the servient status of employee rather than the adventurous role of entrepreneur.

Justice Brandeis, in his famous article on competition, goes into more detail making that same point, and I thought I might read it but I think I will not. If you would like, I could supplement my comments with reference to the article which Mr. Justice Brandeis wrote on competition in 1913.

Senator RUDMAN. That will be fine.

Mr. MAURO. Congress has not changed the policy which was created when the antitrust laws were enacted. Accordingly, those who are responsible for the laws should not ignore that policy and cannot analyze antitrust problems purely on a technical, economic basis.

The second point I would like to make concerns that policy which is not only clearly incorporated into the antitrust laws but is affirmatively included in other national policy. I make this point in my statement, and it is simply that the interest of small business must be taken into account by the Department of Justice or the Federal Trade Commission when either enforces the antitrust laws.

The National Small Business Act states in its preamble that, "it is the declared policy of the Congress that the Government should aid, counsel, assist, and protect, insofar as is possible, the interests of small business concerns in order to preserve free competitive enterprise."

It seems to me, therefore, that antitrust policy does not exist in a vacuum but should reflect the above policy. We do not think that these values are being considered when antitrust decisions are made today. In my statement, I list examples of some policy areas in which we believe the administration and the Federal Trade Commission appear to be ignoring the statutory mandate to consider small business interests.

In view of our tight schedules, I do not have any further comments at this time. However, I would like to say one thing. As an antitrust attorney, I have had some experience over the last couple of years with small businesses who are the victims of vertical restraints. If I may say, a great deal of suffering can be created out there by suppliers who think they can dictate to an independent small businessman how that businessman will conduct his business.

You have heard Mr. Walter's testimony. His company has other ways of surviving the loss of his Apple business. Apparently, he is going to lose a significant amount of money as a result of the Apple termination, but he is still in business. I have clients, however, who are no longer in business as a result of what I believe are clear violations of the law. When that happens—when they are terminated because they will not follow price dictated by the supplier or because they stray from the allowed territory—termination in that situation causes a very severe and significant amount of suffering. I think that that point should be made here on this record, and I appreciate the opportunity now to make it.

[The prepared statement and supplemental information of Mr. Mauro follow:]

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STATEMENT OF THOMAS A. MAURO
ON BEHALF OF THE
SMALL BUSINESS LEGISLATIVE COUNCIL
BEFORE THE
SENATE COMMITTEE ON SMALL BUSINESS
AND THE
SENATE APPROPRIATIONS SUBCOMMITTEE
ON STATE, JUSTICE, COMMERCE,
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SEPTEMBER 9, 1982

> "It is the declared policy of the Congress that the Government should aid, counsel, assist, and protect, insofar as is possible, the interests of small business concerns in order to preserve free competitive enterprise. . . ."
>
> (P.L. 85-536, as amended, Section 2(a), Small Business Act.)

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*Of the National Small Business Association

STATEMENT OF THOMAS A. MAURO ON BEHALF OF THE SMALL BUSINESS LEGISLATIVE COUNCIL BEFORE THE SENATE COMMITTEE ON SMALL BUSINESS AND THE SENATE APPROPRIATIONS SUBCOMMITTEE ON STATE, JUSTICE, COMMERCE, THE JUDICIARY AND RELATED AGENCIES

SEPTEMBER 9, 1982

Mr. Chairman and Members of the Senate Committee on Small Business and the Appropriations Subcommittee on State, Justice, Commerce, the Judiciary and Related Agencies:

This statement is submitted on behalf of the Small Business Legislative Council (SBLC), an organization of some seventy-four national business and trade associations. Our members represent approximately 4.5 million small business units covering almost the full range of SIC classifications.

My name is Thomas A. Mauro. I am an antitrust attorney with offices here in Washington, D.C. and have the honor of serving on the Antitrust Committee of the Small Business Legislative Council. My colleague and Vice President and General Counsel of the Direct Selling Association, Jared O. Blum, is Chairman of the Antitrust Committee, and together we are pleased to present these comments on behalf of the Committee.

One purpose of these hearings is to examine the state of Government antitrust enforcement now that the programs of the Administration's Antitrust Chief at the Department of Justice and the policies of the Chairman of the Federal Trade Commission have taken shape and are, to some extent, being implemented through specific action. The SBLC is honored to represent the views of small business on the relationship between the values reflected in our federal antitrust laws and small business and has been privileged to do so many times before the Congress. We believe it is vital that such an examination be conducted at this time. Proud that our views are well known, we are confident of their acceptance by those, like the members of your Committee, who are the guardians of values we seek to preserve. But we are distressed that within the Government those who have voluntarily assumed responsibility for enforcing our antitrust laws instead persistently seek to substitute their view of what the law should be for what the law is. When Assistant Attorney General Baxter and Chairman Miller and their chief deputies were confirmed by Congress, they agreed to do no less than to enforce the laws and policies now in place. These hearings are quite appropriate, therefore, and the SBLC is especially pleased to take this opportunity to testify on this timely subject.

It is quite plain that the views of small business have fallen on deaf ears within the Government's antitrust enforcement program, particularly in the Department of Justice. Small business continues to bear the brunt of a severely sluggish economy. President Reagan, in his State of Small Business Report, issued on March 1, 1982, recognized the plight of small business in today's economy; but he also expects that small business will significantly influence the nation's economic recovery.[1] His message applauds the contributions small business makes to the creation of new jobs (two out of every three), to innovation (twice as many per employee), and to competition. The success of the American economy is "critically dependant" upon the preservation of real opportunity for small business, stated the President.[2] Thus, he called on the Justice Department to use its antitrust enforcement powers consistently and without hesitation "to the extent that federal antitrust enforcement can influence competition."[3] Yet - and we do not believe we understate the situation - we are witnessing today determined efforts to reverse and effectively gut ninety years of antitrust enforcement tradition. Such efforts constitute grave and very real threats to small business and to the country.

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[1] The State of Small Business: A Report of the President, March, 1982, at 5.

[2] Id. at 3.

[3] Id. at 16.

The vitality of small firms and of the small business sector is threatened by the relentless and sophisticated accumulation of power and wealth by the bigs, as it has been in no other time in our history. The President's Report includes these rather sobering statistics. Although 99% of the approximately 15,000,000 businesses identified by the President employ 500 employees or less, in 1977 small businesses accounted for only 38% of the gross national product. Twenty years earlier, small business' share was approximately 48%. Almost half of this 10% decline (4.7%) accrued during the last five years of this period (1972-1977). At the same time, the employment share of companies with under 500 employees was only two percentage points lower in 1977 than it was in 1958, 55.2% versus 52.5%. Thus, big business has been able to significantly increase its GNP share using relatively fewer employees.

The support for a continued existence of a viable and growing small business segment of our economy is not at all based on sentiment, a longing for the good old days of the one man or one man and wife enterprise. Over the decades, public policy pronouncements and actions that are hospitable in intent by Congress and various administrations have been based on sound and most practical public policy considerations. Chief among these is the recognition that it is the smalls, not the bigs, that lead in the creation of new jobs. It is the smalls, not the bigs, that lead in innovations. And it is the small business unit upon which we must rely to provide the essential element of competition so as to protect all of us against the abuses of monopoly power, the deliberate limiting of production to sustain ever higher prices, the divisions of markets or end customers, and even price fixing.

We are distressed that these values do not seem to have a place in the Government's antitrust program today. Indeed, Assistant Attorney General Baxter, for one, seems quite insensitive to the role small business must play in the formulation of antitrust policy. In an interview reported in the August 3, 1981 issue of U.S. News and World Report, Mr. Baxter was asked the following question: "Do small firms have anything to fear from this Administration's enforcement of the antitrust laws?" Mr. Baxter's answer was as follows: "To the extent we succeed in enhancing the efficiency of some industries by administering a more coherent, economically based, efficiency-oriented version of antitrust, price levels will fall, and some small enterprises will probably be squeezed out of those markets." Mr. Baxter has referred to the Robinson-Patman Act as full of "absurdities" (American Lawyer, July 1981), and as an "unjustified protection for small business from the rigors of competition." (New York Times, April 26, 1981.) Now, according to an article appearing in the August 13, 1982 Washington Post, Mr. Baxter would even permit illegal resale price fixing because, in his view, the present law on the subject does not make sense.

The timing of this hearing is fortuitous, given recent developments in the antitrust area, and indeed the concerns about antitrust enforcement are bipartisan. This hearing, and that being chaired by Congressman Luken today in the House, indicate that the breadth of concern of this issue is crossing political boundaries and goes to the issue of whether our laws are being enforced.

The current antitrust philosophy notwithstanding, it is a fact that the role of small business in our free enterprise system is simply not a matter which may be dealt with at the discretion of the Administration. With all due respect, we submit that enforcement policy cannot ignore or give short shrift to small business. We refer, for example, to House Report No. 94-1738, entitled "A Report of the Ad Hoc Subcommittee on Antitrust, the Robinson-Patman Act, and Related Matters of the Committee on Small Business, House of Representatives," issued September 30, 1976. The Committee Report emphatically reaffirms a national policy which requires that small business concerns be integrated into Government action, and, indeed, that these concerns be treated as matters of primary importance. Citing Section 2(a) of the Small Business Act, 15 U.S.C. §631(a), the Subcommittee states:

> The Congress has clearly expressed its intent and policy respecting small business in the following language:
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> > "The essense of the American economic system of private enterprise is free competition. Only through full and free competition can free markets, free entry into business, and opportunities for the expression and growth of personal initiative and individual judgment be assured. The preservation and expansion of such competition is basic not only to the economic well being, but to the security of this Nation. Such security and well-being cannot be realized unless the actual and potential of small business is encouraged and developed. It is the declared policy of the Congress that the Government should aid, counsel, assist, and protect, insofar as is possible, the interests of small business concerns in order to preserve free competitive enterprise, to insure that a fair proportion of the total sales of Government property be made to such enterprises, and to maintain and strengthen the overall economy of the Nation."
>
> In the Small Business Act, quoted above, the public policy of the United States is unequivocably declared.

Report, supra., at 10.

It follows, therefore that antitrust enforcement policy does not, as economists might have us believe, exist in a vacuum, but should also reflect the above-mentioned national policy. It is a truism that small business relies on vigorous enforcement of the antitrust laws. This is so because the antitrust laws were enacted in recognition of small business as economic challenger. Antitrust was then, and is now, a means for assuring the survival of the small business sector - a large number of firms that can check the monopolistic tendencies of companies grown large enough to exercise some degree of control over their markets.

With the above as background, let us examine briefly how the Administration has thus far carried out its mandate to enforce the law. First, in the area of mergers.

The long awaited Department of Justice (revised) Merger Guidelines and parallel Federal Trade Commission Statement on Horizontal Mergers have only just been issued. The SBLC welcomes the Government's new merger criteria. Uncertainty about Government enforcement standards and a desire to formulate a more specific market share analysis apparently led to the new guidelines.[4] However, while we find the guidelines generally acceptable, they should not be used as a stepping stone to rewrite the laws on mergers.

Chairman Miller, for example, recently noted that the new merger guidelines of both his agency and that of Assistant Attorney General Baxter would create "a zone of 'presumptive legality' [which] may encourage the consumation of mergers having positive effects upon efficiency and competition . . . that otherwise would not be attempted because of fear of governmental intervention."[5] However, under Section 7 of the Clayton Act it is not a defense to an otherwise illegal combination that the new combination would result in certain economic efficiencies. The Supreme Court has held repeatedly that efficiency cannot justify a merger. See, e.g., Brown Shoe Co. v. United States, 370 U.S. 294 (1962); United States v. Philadelphia National Bank, 374 U.S. 321 (1963); FTC v. Procter & Gamble Co., 386 U.S. 568 (1967). We hasten to note that on this issue Chairman Miller recognizes that he departs company on this issue with his fellow Commissioners, who agree that the issue of efficiencies cannot be treated as a legally cognizable defense.[6]

Consider next the Robinson-Patman Act. There is no antitrust law more strongly supported by the small business community than this anti-discrimation law. The Department of Justice simply ignores this basic statute, which is contained in Section 2 of the the Clayton Act; the FTC's Bureau of Competition, on the other hand, from time to time has been quite diligent in its enforcement. Small business knows too well that lacking Government efforts, this law will be honored more in the breach than in the

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4/ See the Statement of the Attorney General and the FTC Statement on Horizontal Mergers, June 14, 1982, reprinted in 42 Antitrust & Trade Reg. Rep. (BNA) at S-11-S-16 (1982).

5/ Remarks of James C. Miller III Before The Japan Federation of Economic Organizaitons, August 23, 1982, at 15.

6/ See note 4, supra., at S-14.

observance. This is a problem area of basic, immediate and vital concern to our entire small business constituency.

It is clear that the Justice Department's antitrust lawyers know that price and other forms of discrimination are a favorite and frequently employed tool of the monopolist, or the would-be monopolist. In the leading monopoly cases brought by the Justice Department, price discrimination as well as predatory pricing have played a prominent role. But in recent years, the Department's antipathy for Robinson-Patman has become well known and it is plain that we cannot expect the Department to raise Robinson-Patman claims in anything other than a Sherman Act context.

The small business community cannot explain why the Justice Department refuses to enforce the Act. One reason was advanced in 1975 when the then Assistant Attorney General in charge of the Antitrust Division, Thomas Kauper, testified that the Robinson-Patman Act should be reformed because the Act is used as a defense in price fixing proceedings. Professor Kauper thus explained that Robinson-Patman violations could be covered by actions brought under Section 1 or Section 2 of the Sherman Act.7/ There is nothing in the Act that compels competitors to talk to each other about prices. And, of course, subsequently, the Supreme Court resoundingly rejected that contention in the United States v. United States Gypsum Company decision.8/.

In accordance with an informal interagency agreement, the Federal Trade Commission has assumed the responsibility of bringing Government claims under the Robinson-Patman Act. I am attaching to this testimony data compiled by Anthony Robinson, Senior Economist, Office of Economic Research, United States Small Business Administration, on the number of antitrust cases commenced by the Government, focusing

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7/ Testimony of Thomas E. Kauper, Assistant Attorney General, Antitrust Division, before the Ad Hoc Subcommittee on Antitrust, the Robinson-Patman Act, and Related Matters of the Committee on Small Business, House of Representatives, 94th Congress, 1st Sess., at 588.

8/ 438 U.S. 422 (1978).

on enforcement of the Robinson-Patman Act, through June 1981. It is plain that since 1975 the number of Robinson-Patman Act cases brought is insignificant. Small business is looking to the current administration of the Commission to change this very disturbing trend. Though we may disagree with Chairman Miller on some issues including R-P, we applaud his continued statements of his intent to enforce the law, and his ongoing outreach program at the Commission to the small business community.

But according to Chairman Miller in his recent speech before the Japan Federation of Economic Organizations, only persistent price discrimination conduct cases will be brought. Under this theory, the bodies will have to be in plain sight and strewn throughout the landscape before Mr. Miller will vote to bring a Robinson-Patman complaint. "Price discrimination which is merely episodic [deserves] applause rather than prohibition," he says. Id. at 30.

Price discrimination is illegal. Moreover, Congress has considered and expressly rejected proposals which would allow the kinds of episodic price discrimination that would appear to be sanctioned by Chairman Miller. In the FTC's own experience, it is recognized that such a provision would insure the demise of many small sellers. Please see the testimony of Ernest G. Barnes, Assistant Chief Administrative Law Judge, FTC, before the Ad-Hoc Subcommittee, supra., Part 2 at pages 172-173. Judge Barnes refers to an FTC proceeding brought against the Kraft Company involving the type of episodic price discrimination discussed here. We believe that the conduct of the Kraft Company resulted in the loss of several small businesses in the jams and jellies industries - some of which were quite substantial - in the middle Atlantic area and we request this Committee seek data from the Commission on the Kraft takeover of the jams and jellies industries and on a related proceeding entitled National Dairy Products Corporation v. Federal Trade Commission, FTC Docket No. 6465. These were examples of episodic price discrimination which the Commission at that time condemned. To our knowledge, there has been no modification of the law concerning episodic price discrimination.

Finally, if there is evidence supporting the view that Robinson-Patman is anticompetitive, the SBLC again requests that the critics of the Act immediately come forward with such evidence. We asked for such information in testimony before this Committee on December 1, 1981, and again in testimony on April 1, 1982, concerning the reauthorization of the FTC. Indeed, since 1976 Congress has sought data from the Department of Justice which support the Department's charge that the Robinson-Patman Act discourages competition.[9/] Yet statements advocating a change in the law by our antitrust prosecutors continue to be made without such justification.

Finally, we are attaching to this statement a copy of the findings of the Ad-Hoc Subcommittee, supra., concerning the Robinson-Patman Act. You will note the Committee's unqualified support of the Act, and in particular, its finding that the "unfounded, erroneous and unjustified allegations made against the antitrust laws in general, and the Robinson-Patman Act specifically, have had the ill effects of confusing citizens and Governmental officials. . . ." The SBLC urges this Committee to reiterate to these officials its continued support of the law.

Let us now turn, finally, to the area of vertical restraints. On October 30, 1981 Ronald G. Carr, Deputy Assistant Attorney General, Antitrust Division, told the Ohio State Bar Association that vertical restraints, in the Division's scheme of things, should be placed somewhere down the enforcement line, "possibly to the point of vanishing." See Mr. Carr's comments at 2. Further, Mr. Carr viewed resale price maintenance, which is per se illegal, as having some beneficial effect. Id. at 4-5. Assistant Attorney General Baxter has only recently been reported as stating that he would permit manufacturers under certain circumstances to dictate the prices charged by stores for specified products, Washington Post, August 13, 1982. We can debate the merits or the disadvantages of allowing manufacturers free reign over their

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[9/] See letters to the Honorable Thomas E. Kauper and Harold R. Tyler, Jr., Hearings Before the Ad-Hoc Subcommittee, supra., part 1, at 584-585.

independent dealers on the grounds of efficiency. Indeed, it may well be folly to accept the economic ideal of efficiency as paramount, a value to which all other are subordinate. In our political life we have learned to fear power as such - too much power in too few hands. But one thing beyond debate is that today resale price maintenance is *per se* illegal. We began this testimony by commenting that there appears to be a determined effort to reverse a ninety-year tradition of antitrust enforcement. We can think of no better example of this effort and of no legitimate excuse for the Government's refusal to enforce the law as it now exists.

CONCLUSION

In conclusion, let us say that the proposals that have been emanating from Government officials who are charged with enforcing the law appear in fact to be proposals to eliminate a great deal of our national antitrust policy - a national treasure which is the result of decades of labor by Congress, by the Courts, and by independent Government agencies. We think it obvious that the future of small business is inextricably tied to this policy. We will continue to make our voices heard and deeply appreciate this opportunity to do so.

Thank you Mr. Chairman.

Table 1
Antitrust Cases Commenced, During the Twelve Month Periods Ended June 30, 1960 through 1981

Year	Total	U.S. Cases		Private Cases	
		Civil	Criminal	Electrical equipment industry	Other[4]
1960 ...	315	60	27	-	228
1961 ...	441	42[1]	21	37	341
1962 ...	2,079	41[1]	33	1,739	266
1963 ...	457	52[1]	25	97	283
1964 ...	446	59	24	46	317
1965 ...	52.	38	11	29[2]	443
1966 ...	770	36	12	278[3]	444
1967 ...	598	39	16	7[3]	536
1968 ...	718	48	11	-	659
1969 ...	797	43	14	-	740
1970 ...	933	52	4	-	877
1971 ...	1,515	60	10	-	1,445
1972 ...	1,393	80	14	-	1,299
1973 ...	1,224	54	18	-	1,152
1974 ...	1,294	40	24	-	1,230
1975 ...	1,467	56	36	-	1,375
1976 ...	1,574	51	19	-	1,504
1977 ...	1,689	47	31	-	1,611
1978 ...	1,507	42	30	-	1,435
1979 ...	1,312	50	28	-	1,234
1980 ...	1,535	39	39	-	1,457
1981 ...	1,434	60	82	-	1,292

[1] Includes 9 U.S. electrical industry cases filed in 1961, 2 in 1962 and 3 in 1963.

[2] Includes 26 cases transferred under Title 28 U.S.C. Section 1404(a).

[3] All cases were transferred under Title 28 U.S.C. Section 1404(a).

[4] Includes antitrust cases transferred under Title 28 U.S.C. Section 1407.

Table 2(a)

FTC Enforcement of The Robinson-Patman Act, 1937-1981

Fiscal Year	Number of Complaints Issued Section 2(a)	Section 2(c)	Section 2(d)	Section 2(e)	Section 2(f)	Total
1937	16	5	5	7	3	36
1938	13	4	1	0	1	19
1939	24	5	3	2	1	35
1940	20	3	12	7	1	43
1941	11	43	2	2	0	58
1942	8	4	4	1	2	19
1943	6	9	0	1	2	18
1944	8	9	4	0	1	22
1945	1	17	3	2	0	23
1946	3	8	0	0	1	12
1947	3	8	1	0	0	12
1948	13	10	10	10	0	43
1949	31	31	28	24	1	115
1950	15	1	1	1	3	22
1951	8	5	4	0	1	18
1952	11	1	2	1	2	17
1953	9	3	1	1	0	14
1954	5	4	4	2	0	15
1955	12	7	1	1	0	21
1956	2	3	21	5	0	31
1957	18	8	16	0	2	44
1958	24	22	20	4	6	76
1959	22	24	24	22	2	74
1960	48	45	43	4	4	144
1961	12	39	49	33	2	105
1962	2	13	26	0	0	41
1963	8	13	192	2	0	215
1964	5	0	20	0	0	25
1965	4	0	7	0	1	12
1966	3	0	10	1	2	16
1967	2	2	3	1	1	9
1968	2	2	0	0	0	4
1969	9	1	1	0	0	11
1970	4	6	0	0	1	11
1971	4	0	5	1	2	12
1972	N.A.	N.A.	N.A.	N.A.	N.A.	1
1973	N.A.	N.A.	N.A.	N.A.	N.A.	1
1974	N.A.	N.A.	N.A.	N.A.	N.A.	6
1975	N.A.	N.A.	N.A.	N.A.	N.A.	0
1976	N.A.	N.A.	N.A.	N.A.	N.A.	1
1977	N.A.	N.A.	N.A.	N.A.	N.A.	1
1978	N.A.	N.A.	N.A.	N.A.	N.A.	1
1979	N.A.	N.A.	N.A.	N.A.	N.A.	0
1980	N.A.	N.A.	N.A.	N.A.	N.A.	1
1981	N.A.	N.A.	N.A.	N.A.	N.A.	1

Source: Table 1, The Robinson-Patman Act, Federal Regulation of Price Differences, Richard A. Posner, American Enterprise Institute for Public Policy Research, Washington, D.C. 1976, and Trade Regulation Reporter, FTC Complaints and Orders, Commerce Clearinghouse, Inc., Chicago, Illinois.

Table 2(b)

Federal Trade Commission Robinson-Patman Orders Since the Finality Act

Fiscal Year	Section 2(a)	Section 2(c)	Section 2(d)	Section 2(e)	Section 2(f)	Total
1960	5	6	33	1	1	46
1961	11	56	18	1	4	90
1962	11	37	24	2	1	75
1963	7	17	225	2	1	252
1964	28	1	81	4	2	116
1965	5	1	32	0	0	38
1966	5	0	65	0	2	72
1967	8	1	9	1	0	18
1968	3	6	2	1	1	13
1969	3	6	0	0	1	10
1970	6	0	2	0	0	8
1971	5	0	6	3	1	15
1972	1	2	1	0	0	4
1973	1	2	0	0	0	3
1974	1	0	2	0	0	3
1975	2	2	0	1	0	5
*1976	N.A.	N.A.	N.A.	N.A.	N.A.	2
1977	N.A.	N.A.	N.A.	N.A.	N.A.	1
1978	N.A.	N.A.	N.A.	N.A.	N.A.	1
1979	N.A.	N.A.	N.A.	N.A.	N.A.	1
1980	N.A.	N.A.	N.A.	N.A.	N.A.	1
1981	N.A.	N.A.	N.A.	N.A.	N.A.	3

*The data since F.Y. 1976 include only consent orders and final orders. Pre-1976 data may include interlocutory orders which may result in having more than one order associated with a particular case.

Source: U.S. Congress, Recent Efforts to Amend or Repeal The Robinson-Patman Act, a Report of the Ad Hoc Subcommittee on Antitrust, The Robinson-Patman Act, and Related Matters of the Committee on Small Business, p. 128-132, and Trade Regulation Reporter, FTC Complaints and Orders, Commerce Clearinghouse, Inc., Chicago, Illinois.

Table 2(c)

Complaints, Consent Orders, and Final Orders
Issued by the Federal Trade
Commission on the Robinson-Patman Act
by Fiscal Years 1975-1981

Fiscal Year	Complaints	Consent Orders & Final Orders
1975	0	1
1976	1	2
1977	1	1
1978	1	1
1979	0	1
1980	1	1
1981	1	3

Source: *Trade Regulation Reporter*, *FTC Complaints and Orders*, Commerce Clearinghouse, Inc., Chicago, Illinois.

Table 3, Analysis of Robinson-Patman Decisions as Reported in CCH, Trade Cases in 1980. ¶ 63,000 - 63,569.

¶		Plaintiff	Defendant	Decision Held For:
63229	1	S	B	Defendant/B
63281	2	S	B	Defendant/B
63022	3	S	B	Defendant/B
63067	4	S	B	Defendant/B
63194	5	S	S	Defendant/S
63343	6	S	B	Defendant/B
63364	7	B	S	Plaintiff/B
63404	8	S	B	Defendant/B
63367	9	S	B	Defendant/B
63357	10	S	S	Plaintiff/S
63291	11	S	S&B	Defendant/S&B
63562	12	S	S&G	Defendant/S&G
63434	13	S	B	Defendant/B
63538	14	S	B	Defendant/B
63313	15	S	S	Defendant/S
63430	16	B	B	Defendant/B
63555	17	S	B	Defendant/B
63491	18	B	B	Defendant/B

Key: S = Small Business; B = Big Business; G = Governmental Entity.

Union Calendar No. 866

94th Congress, 2d Session - - - - - - - - House Report No. 94–1738

RECENT EFFORTS TO AMEND OR REPEAL THE ROBINSON-PATMAN ACT

A REPORT

OF THE

AD HOC SUBCOMMITTEE ON ANTITRUST, THE ROBINSON-PATMAN ACT, AND RELATED MATTERS

OF THE

COMMITTEE ON SMALL BUSINESS

HOUSE OF REPRESENTATIVES

TOGETHER WITH

ADDITIONAL VIEWS

SEPTEMBER 30, 1976.—Committed to the Committee of the Whole House on the State of the Union and ordered to be printed

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CHAPTER XIV. FINDINGS AND CONCLUSIONS

The Ad Hoc Subcommittee on Antitrust, the Robinson-Patman Act, and Related Matters of the Committee on Small Business, House of Representatives, finds and concludes that:

1. The Robinson-Patman Act, which is an important part of the antitrust laws of the United States, should not be repealed nor emasculated nor weakened in any way whatsoever; neither should it be amended. However, in order to provide additional leverage in furtherance of the beneficient purposes of this time-proven law, Section 3 of the Robinson-Patman Act should, by Congressional action, be included within the term "antitrust laws."

2. The Robinson-Patman Act has implemented the clearly expressed national public policy "* * * that the Government should aid, counsel, assist, and protect, insofar as is possible, the interests of small business concerns in order to preserve free competitive enterprise * * *." Therefore, the Robinson-Patman Act must be effectively enforced by those Governmental agencies which are charged with the duty to execute and enforce its provisions.

3. "Regulation," as that term is normally used by this and other Congressional committees, means supervisory control by an administrative body that substitutes for the impersonal control of the free market. In that sense, neither the Robinson-Patman Act nor other provisions of law making it illegal to use price discriminatory acts or practices are regulations of business. The antitrust laws, of which the Robinson-Patman Act is an integral part, do not require the promulgation of regulations to control business activities. The antitrust statutes merely require that business avoid such acts and practices which restrain, injure, damage, or destroy small business through price discriminatory practices or tend to create a monopoly. The provisions of the Robinson-Patman Act call for no paperwork on the part of businessmen who comply with the spirit and intent of the law. Calling one thing or law by a different name cannot possibly change the true character of that thing or statute.

4. It appears that certain special interests who oppose the antitrust laws, including the Robinson-Patman Act, have mounted strong and vigorous campaigns, including lobbying activities and making erroneous charges to the effect that the Robinson-Patman Act impedes competition. Such activities and allegations were made by these special interests and others in their efforts to weaken or repeal the Robinson-Patman Act which together with the other antitrust laws are, in fact, a basis for economic freedom of Americans. Therefore, vigilance is needed and prompt action required to oppose these special interest groups and other individuals who would like to emasculate or even do away with such needed laws.

5. The unfounded, erroneous and unjustified allegations made against the antitrust laws in general, and against the Robinson-Pat-

man Act specifically, have had the ill effects of confusing citizens and governmental officials and misleading them into the belief that those laws against price discrimination practices destructive of competition are anticompetitive and undesirable and should be repealed.

6. The lobbying activities and unjustified allegations made against the Robinson-Patman Act had the further unfortunate effect of persuading or leading some public officials who are charged with the duty, responsibility, and obligation to enforce this law, to refrain from its full and complete enforcement with the result that the Congressional intent is thwarted and a bureaucratic repeal effected. The Ad Hoc Subcommittee condemns such lobbying activities on the part of special interest groups as well as others so lobbying.

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September 20, 1982

Senator Warren Rudman
Committee on Small Business
United States Senate
424 Russell Senate Office Building
Washington, D.C. 20510

Re: Hearings on September 9, 1982

Dear Senator Rudman:

During my testimony before your Committee on September 9, 1982 you were kind enough to permit me to supplement my testmony. Accordingly, please accept these additional documents on issues which we believe are highly pertinent to your hearings.

Much has been recently written and said on the subject of efficiency and the antitrust laws. This debate is not new and, in fact, was among the factors considered by Congress when it enacted the laws. I would like to refer to the article written by Louis D. Brandeis entitled "Competition". This article first appeared at 44 American Legal News, 5-14 in January 1913. As you know, Mr. Justice Brandeis was a champion of the antitrust laws and was highly instrumental in the enactment of the Clayton and Federal Trade Commission Acts in 1914. At that time critics of the antitrust laws also argued that diligent enforcement of the new laws would create waste and inefficiency. Mr. Justice Brandeis responded as follows:

> Earnest argument is constantly made in support of monopoly by pointing to the wastefulness of competition. Undoubtedly competition involves some waste. What human activity does not? The wastes of democracy are among the greatest obvious wastes, but we have compensations in democracy which far outweigh that waste and make it more efficient than absolutism. So it is with competition. Incentive and development which are incident to the former system of business result in so much achievement that the accompanying waste is relatively insignificant. The margin between that which men naturally do and which they can do is so great that a system which urges men on to action, enterprise, and initiative is preferable in spite of the wastes that necessarily attend that process. I say, 'necessarily' because there have been and are today wastes incidental to competition that are unnecessary. Those are the wastes which attend that competition which do not develop, but kill. Those wastes the law can and should eliminate. It may do so by regulating competition.*

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* Reprinted in The Brandeis Reader, Ervin H. Polick, Professor of Law, Ohio State University, Editor, at 176 (1956).

It is apparent that Justice Brandeis' comments are just as forceful today as they were in 1913.

Turning now to the question of Mr. Baxter's comments to The Washington Post published on August 13, 1982. You may recall that my colleague, Randy Seifert, referred to a letter written by Assistant Attorney General Baxter concerning certain of his views on antitrust enforcement, particularly as it concerns resale price maintenance. We enclose for the record a copy of our communications with the Department of Justice and ask that they be made a part of this record.

On behalf of the Small Business Legislative Council, I would again like to thank you and the Committee for the opportunity to testify and to present material on a very timely subject. Important questions have been raised during these hearings. Please be assured that we are anxious to continue to be of service in providing our views on these matters.

With kind regards.

Sincerely yours,

Thomas A. Mauro
Member, Antitrust Committee
Small Business Legislative Counsel

Enclosure

bcc: Herb Leibenson (w/o encl.)
Jared Blum (w/o encl.)
Brian Hartman (w/o encl.)

Senator **Rudman**. Well, thank you very much, Mr. Mauro.

Mr. **Seifert**. Mr. Chairman, could I just add three quick comments?

Senator **Rudman**. You certainly may.

Mr. **Seifert**. With respect to Professor Baxter's comments earlier, the likelihood is you are going to get a letter which we have only just received from Mr. Baxter concerning the statements attributed to him in the Washington Post. The essence of the letter is that he is seeking to change the Supreme Court point of view and that disagrees strongly with the rule on resale pricing methods.

He has, in effect, asked the private bar to develop cases in which he can participate to bring that about, and which would be appropriate for the Supreme Court to review that. I suggest that, with respect to his answers to you, Mr. Chairman, and to some of the other colleagues of yours on this committee, I think what he was saying was that he was upholding the law.

The fact of the matter is that any resale price maintenance cases he is preparing are in the interest of upsetting the current state of the law.

Second, with respect to the current activities of the Department of Justice, appended to Tom Mauro's statement is a list of the cases brought by the Department of Justice in recent years. It shows the activity in 1981 as some 82 criminal cases.

In the hearings this morning before the House committee paralleling these, a number of people commented on those cases. Almost without exception, the cases brought by the Department of Justice are cases in the paving industry.

Senator **Rudman**. We are aware of that.

Mr. **Seifert**. Almost all of those are against the small business community; and far from being cases brought against substantial malefactors in the horizontal area, which Mr. Baxter said he is doing, these cases may be horizontal, but the people who are going to jail are the people who cannot afford to defend those actions. Almost without exception, those are consent orders and jail terms that are worked out and the small business community really is paying the price.

Finally, one last, quick comment, Mr. Chairman. With respect to your general rule and what you have done since you have been here, this hearing and prior hearings were a breath of fresh air to the small business community. You have asked some pointed questions with respect to the work of the Department of Justice. We do not think that those questions have been asked to date. Should there be more criminal cases?

You asked pointedly on the *Mercedes* case, a per se rule strongly ensconced in law overthrown and dropped. Should that be the case? The merger question. The merger figures far exceeded last year any other previous year. Are these appropriate or worthwhile?

And so I think your interest and followup with respect to the Department of Justice activity is a very welcome addition to the small business community.

Thank you so much.

Senator **Rudman**. Thank you both for your comments.

I point out that both Senator Gorton and I, in our prior work, understand something about prosecutorial discretion. Every prosecutor must have discretion. Every administrator charged with enforcing civil law must have discretion.

The question, of course, before the committee this morning, the overriding question, that which underlays most of the questions, was, Is this discretion becoming something else? Has it become deliberate policy to attempt to change the law while not observing the law that exists? That, of course, is what this record, I think, discloses.

I would expect that since this is a joint hearing involving both the Small Business Committee and, I think very appropriately, Senator Weicker's Subcommittee on State, Justice, and Commerce of the Appropriations Committee, I expect that before this is all over, we are going to have some direction of some kind to the Justice Department. If Mr. Baxter wants to change some laws—and he may have excellent economic justification to change some—I think he is undoubtedly a brilliant expert in the field. I may disagree with him, but I certainly think that he has a right to his point of view. I think he ought to be before us and not before the courts so much, and we are going to have something to say about that.

Mr. **Seifert**. I think it ought to be pointed out, too, Mr. Chairman, that there is a compilation of those Robinson-Patman actions brought by the Federal Trade Commission. In the sixties, there were 200 cases a year instituted by the Commission, even into the early seventies. In the last 4 years, there was one case a year.

At the same time in the private sector, those were four figures. You are well into the thousands of cases. We are simply saying that the Federal Trade Commission is on strike with respect to Robinson-Patman. They are literally bringing no cases.

Senator **Rudman**. We are aware of that.

We are going to keep the record open until the 23d and, if necessary, maybe a small extension beyond that, because I want the staff to send a transcript of this hearing to the Apple Corp. I think they really ought to have their views represented in the hearing transcript.

Thank you for being here.

The subcommittee and committee will stand in recess.

[Whereupon, at 12:58 p.m., the committee and subcommittee recessed, to reconvene at the call of the Chair.]

[Subsequent information was received and follows:]

apple computer inc.
20525 Mariani Avenue
Cupertino, California 95014
(408) 996-1010

Albert A. Eisenstat
Vice President and General Counsel

November 10, 1982

The Honorable Lowell Weicker, Jr.
c/o Hearing Clerk
Senate Committee on Small Business
424 Russell Senate Office Building
Washington, D.C. 20510

RE: Response of Apple Computer, Inc. to
Senate Committee on Small Business

Dear Senator Weicker:

This letter is in response to your letter of last month offering Apple Computer, Inc. the opportunity to submit materials for incorporation into the printed record respecting the September 9, 1982, hearings of the Senate Committee on Small Business.

We are aware, of course, that a former Apple dealer, Francis Ravel of Los Angeles, California, brought before the Committee last April the fact that Apple prohibits the mail order sale of its products. As your letter indicates, the Committee took additional testimony on this matter during its September 9, 1982 session. We welcome the opportunity to explain Apple's prohibition to you and to the Committee.

We have carefully considered the best mechanism for providing you with this information. We have concluded that the development, operation of and justification for the mail order prohibition is explained most thoroughly in a memorandum which Apple filed last year in Federal Court in Los Angeles.

As you are doubtless aware, Mr. Ravel and a handful of other Apple dealers brought suit last December to temporarily restrain, and preliminarily and permanently enjoin Apple from implementing its prohibition on mail order sales. The United States District Court for the Central District of California, the Honorable Consuelo B. Marshall presiding, denied plaintiffs' request for a temporary restraining order on December 4, 1981. The Court then established a briefing schedule and, after considering the submissions of the parties and the arguments of counsel, denied the motion of Mr. Ravel and the other dealers for preliminary injunctive relief. The Court stated:

> It would be the Court's position that the Court does not feel there is a serious question as to the law involved here and as to the claims being made by plaintiffs nor does the Court feel there is a sufficient showing of likelihood of success by the plaintiffs.

Reporter's Transcript of Proceedings, December 21, 1981 at p.p. 96-97.

We are providing you with a copy of the memorandum we submitted to the Court, upon which the Court's decision was based. Apple's submission also contained a large number of exhibits, but the memo is completely comprehensible without them, and in order to avoid burdening the Committee's record, we are not submitting these exhibits at this time. Of course, if you desire them, we will be happy to provide them to you, as they are already a matter of public record.

We are sure that after you review our memorandum you will conclude, as did the Court in Los Angeles, that these criticisms of Apple's program do not present a "serious question", and that the actions taken by Apple were entirely proper and within existing law, and were based upon sound business considerations.

Thank you very much for the opportunity to submit these materials.

Sincerely,

Albert A. Eisenstat
Vice President and General Counsel

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UNITED STATES DISTRICT COURT

CENTRAL DISTRICT OF CALIFORNIA

O.S.C. CORPORATION, also known as OLYMPIC SALES COMPANY; CONSUMER COMPUTERS; ADVANCED COMPUTER PRODUCTS; CUSTOM COMPUTER; COMPUTER SPECIALTIES; and MICRO BUSINESS WORLD, INC.,	CASE NO. CV-81-6132-CBM (GX)
Plaintiffs,	Hearing Date: Dec. 21, 1981
vs.	MEMORANDUM OF POINTS AND AUTHORITIES IN OPPOSITION TO PLAINTIFFS' REQUEST FOR A PRELIMINARY INJUNCTION
APPLE COMPUTER, INC.,	
Defendant.	

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This memorandum is submitted by defendant Apple Computer, Inc. (hereinafter sometimes "Apple") in opposition to plaintiffs' motion for a preliminary injunction to prevent Apple from enforcing the modification of its Authorized Dealer Sales Agreement (hereinafter the "Modification"), which these plaintiffs all signed prior to November 20, 1981. By signing the Modification, plaintiffs agreed to refrain from engaging in the mail order sale of Apple products.

This memorandum describes the products which Apple manufactures and the company's position in the highly competitive small computer market. The memorandum then details the bases of Apple's concerns with mail order sales-- lack of pre- and post-sale consumer support and an erosive effect on the company's independent dealer base-- and explains the procedure by which the company reached the conclusion to prohibit mail order sales and the manner by which that prohibition has been implemented.

The memorandum amply demonstrates that plaintiffs have failed to satisfy even one of the three criteria for the imposition of preliminary injunctive relief. Plaintiffs are unable to make the necessary showing of irreparable injury, and the balance of harm in this case decidedly tips in Apple's favor. Furthermore, under the standards uniformly applied to restrictions of this type by the courts, Apple's mail order prohibition is entirely lawful and, indeed, will enhance the extent and degree of competition in the small computer industry. Plaintiffs' arguments to the contrary find absolutely no support in the case law.*

STATEMENT OF FACTS

A. Apple, Its Products, and the Industry in Which It Competes

Apple was founded in 1976 and incorporated in California in early 1977. Carter Dec. at ¶4.** Since its inception, the company has been engaged in the design, development, production, marketing and service of its small computer systems for individual and business applications. Carter Dec. at ¶4; Markkula Dec. at ¶3. The computer systems which Apple manufactures and sells are built around a central processing unit and include peripherals, operating software to control the system, and applications software to solve problems. Carter Dec. at ¶5.; Markkula Dec. at ¶¶ 4-8.

The company's principal computer system is based on the Apple II central processing unit, introduced in 1977, which is packaged in a 5-inch high, 12-pound case. Carter Dec. at ¶6. The Apple II central processing unit is available in a number of different memory sizes. Doherty Dec. at ¶ 8. In 1980, the company introduced the Apple III computer system. The Apple III includes a number of features which are optional accessories for the Apple II, as well as other features not available on the Apple II. Carter Dec. at ¶7.

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* As part of its opposition to plaintiffs' request for a preliminary injunction, Apple also submits herewith the affidavits and declarations of Harold Brookshire, Michael Burwen, Meg Ross Burwen, Gene P. Carter, John T. Doherty, William A. Fenwick, Virginia Fried, John C. T. Green, Linda L. Green, Frederick M. Hoar, Armas Clifford Markkula, Jr., Thomas J. Patterson, Carole Read, Joseph P. Roebuck, Robert H. Rogers, Benjamin M. Rosen, Dennis P. Smith, Ken Soder, Douglas S. Thom, and Ruth P. Wynen.

** All references to affidavits and declarations will be in the form "(Name of declarant) Dec. (or Aff.) at ¶ ___."

The market in which Apple sells its small computer systems is highly competitive. Carter Dec. at ¶9; Markkula Dec. at ¶11; Rosen Dec. at ¶5. Since the beginning of this year alone, at least ten new manufacturers have entered that market, the most significant of which are giant multi-national computer and office equipment companies, International Business Machines and Xerox. Rosen Dec. at ¶5. There are currently more than twenty-one companies, all competing in the same market for the same consumer and business dollars. Rosen Dec. at ¶5; Carter Dec. at ¶9. This trend is expected to continue in the future, and Apple will, therefore, face increased competition from firms substantially larger than it is. Rosen Dec. at ¶5.

Many, if not most of the manufacturers of small computer systems have greater financial, marketing and technological resources than does Apple. Many of these companies are competing for the loyalty of the same independent dealers on whom Apple depends. Furthermore, the stronger competitors in the personal computer market have greater market penetration and name recognition among businessmen and professionals than does Apple. At least three of these competitors already have a sales and support capacity which permits a direct interface between the manufacturer and the ultimate consumer-- Tandy Corporation, Xerox, and IBM. All three companies have developed numerous wholly-owned service and support facilities in every major metropolitan area in the United States and the western world. Apple does not have a similar company-owned network; consequently, Apple must depend entirely on independent dealers to provide an interface with the consumer and to provide support for the sale of Apple products. Rosen Dec. at ¶6; Markkula Dec. at ¶¶ 4-9, 12.

Apple has responded to this increased competition from much larger companies in a number of ways. For example, it has lowered the dealer price on its "higher line" central processing unit, the Apple III, in order to make it more attractive to independent dealers and consumers. Markkula Dec. at ¶31. It has also instituted the National Accounts Program so that Apple and its independent dealers can compete for the business of large corporations which have many remote locations dispersed throughout the country. Roebuck Dec. at ¶¶3,5. Without a program of this type, Apple and its dealers would have lost the business of these corporations to competitors like Xerox, IBM, and Tandy, all of which have the capacity to provide installation, orientation, training, user-support and service that were then beyond the capability of Apple or its authorized dealers individually. Roebuck Dec. at ¶¶3,5. Under Apple's National Account Program, all independent dealers, with the assistance of Apple and other independent dealers, can participate in sales to and servicing of large national and multi-national corporations. Roebuck Dec. at ¶4, 5.*

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* The structure and operation of Apple's National Account Program is described in detail in the Declaration of Joseph P. Roebuck, submitted herewith.

B. Apple's Dependence on Its Independent Dealer Base

From its inception, Apple has used independent retail dealers for the marketing of its products to consumers. Markkula Dec. at ¶4. Apple began to develop a network of independent local retail outlets in 1977. Apple products are currently sold in the United States through approximately 1,000 independent outlets. These outlets are generally computer stores ranging from sole proprietorships to franchises of retail store chains. These stores typically handle a variety of computer-related products, including computer systems manufactured by Apple's competitors. Apple itself owns no retail outlets. Carter Dec. at ¶17.

Each dealer of Apple products in the United States, including these six plaintiffs, has executed an Authorized Apple Dealer Sales Agreement ("Dealer Agreement"). These agreements have no fixed term, but expressly provide for termination by either party on thirty (30) days notice. Carter Dec. at ¶19. The Dealer Agreement does not restrict a dealer to a particular sales territory, but it does provide that the dealer can make sales only from locations approved by Apple in the Dealer Agreement. Carter Dec. at ¶20. Apple's policy of permitting its dealers to set their own resale prices is embodied in the Dealer Agreement. The Agreement also obligates the signatory dealer to report to Apple any attempt by anyone to tell the signatory dealer the resale prices to charge for Apple products or to inhibit the dealer's pricing discretion with respect to those products. Apple has never received a report that dealer pricing discretion was inhibited in any manner. Carter Dec. at ¶21.

Using independent retail dealers to market its products has permitted Apple to secure a broader distribution and representation of its products, even though it does not have the financial strength of many national manufacturers. Rogers Dec. at ¶3. Since these dealers provide the interface between Apple and the purchasers of its products, Apple is wholly dependent on the business vitality of the independent dealers, their goodwill, and their commitment to vigorously promote and support the sale of Apple products. Rosen Dec. at ¶9.

Of course, by using a disparate group of independent retailers, Apple accepted a substantial dealer training obligation, and an enormous burden of providing a vehicle for two-way communication between the manufacturer and the retailers. Rogers Dec. at ¶3. Apple therefore formed a Dealer Advisory Council in June of 1981 so that it would have a mechanism by which to gain information about the marketing of small computer systems. Rogers Dec. at ¶8.* Dealer advisory councils are, of course, very common in other retail areas. Rogers Dec. at ¶8.

C. The Need for Support

There are undoubtedly individuals in the general consuming population who are so highly skilled and technically-oriented that they need little help in purchasing, assembling and operating a small computer system. Apple believes, however, that these individuals represent only a small portion of the potential purchasers of personal computers, and that virtually all such individuals have already made their purchases, if they are economically able to do so. Carter Dec. at ¶12; Rosen Dec. at ¶ 7. Consequently, if Apple's sales strategy were oriented toward individuals who need no support, Apple's potential for growth would be severely limited. Rosen Dec. at ¶7.

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* The formation, structure, and operation of the Dealer Advisory Council are described in the Declaration of Robert H. Rogers, submitted herewith.

Apple's sales and marketing strategy is, therefore, directed toward less technically-oriented individuals and businessmen who have a need for a computer but little or no knowledge as to how a computer might solve their problems. Carter Dec. at ¶13. Unless these potential customers are educated as to the operation and applications of small computers and are persuaded that non-technical people can, with the proper help, learn to program and operate a computer, prospective customers are not going to buy such devices in large numbers. Rosen Dec. at ¶8. In other words, unless Apple finds the mechanism for providing "support" for sales to such individuals, they are unlikely to purchase computers from Apple. Carter Dec. at ¶13; Markkula Dec. at ¶¶ 18, 23.

"Support" begins with assessing a customer's needs. Small computer systems are capable of hundreds of applications which vary in complexity and utility-- applications such as producing budgets, maintaining business records, controlling inventory, word processing, performing complex pricing analyses, and so forth. Different applications require the computer system to consist of different hardware and software components. Markkula Dec. at ¶5. Thus, the proper system cannot be purchased unless the customer's needs are determined.

Even if those needs are known, selecting the proper components is not easy. There are a wide variety of different brands and types of components from which to select. Markkula Dec. at ¶7. Memory sizes of the central processing unit, for example, can range significantly, with corresponding variations in cost. Markkula Dec. at ¶4. An endless variety of data storage devices are available, and the consumer can choose from a large array of printers. Again, of course, costs vary considerably. Markkula Dec. at ¶4. Making the wrong selection of components can not only cost the consumer a great deal of money, it can also render the computer system inadequate or unusable for the consumer's needs.

"Support" also includes assemblying the particular configuration purchased by the customer. The intricacies of assembling a system are by no means trivial. Markkula Dec. at ¶7; Thom Dec. at ¶¶ 3-13. Indeed, it is a challenge for even those consumers who are technically inclined. Very few consumers can assemble even a medium sized personal computer system without substantial assistance from the dealer. Rogers Dec. at ¶4.*

"Support" also includes instructing the customer in the operation of the small computer system. Such instruction includes showing the customer how to "boot" (start up) the system, how to load and operate utility-type programs, how to assign input/output devices, how to handle and copy diskettes, etc. Carter Dec. at ¶15; Markkula Dec. at ¶8. Support, then, necessarily includes face-to-face instruction and supervised

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* The complexities involved in assembling a small computer system for business use are described in detail in the Declaration of Douglas H. Thom, submitted herewith.

"hands-on" experience with the computer. There is simply no viable substitute for such education. Rosen Dec.at ¶10. Of course, another fundamental component of support is simply being in a position to enable the purchaser to come back to the seller when the purchaser has a problem. Carter Dec. at ¶15.

In a properly supported sale, then, the seller fulfills his obligation to show a potential customer how a computer will meet the customer's needs. The seller also anticipates problems that the customer might have, properly trains the customer to deal with those problems, and continues even after making the sale to help the customer resolve difficulties which occur from time to time. In short, the seller does his best to make certain that a customer with a need gets a product which addresses that need, and that the customer is entirely satisfied with his purchase. Carter Dec. at ¶14.

Manufacturers which are successful in providing pre- and post-sale support for their small computer products will have a substantial marketing advantage over those who do not provide adequate support. Rosen Dec. at ¶8. Apple has powerful competitors, such as IBM, Xerox, and Tandy, with sales and support networks in place that can be used to guarantee that the sales of their small computer products are properly supported. Tandy owns most of its outlets. IBM and Xerox own some of their retail outlets and a large number of support centers. Apple does not have similar company-owned facilities; rather, Apple must depend on independent dealers to provide support for the sale of Apple products. Carter Dec. at ¶16.

D. Apple's Concern with Mail Order Sales

Apple has been concerned for some time about the mail order sale of its products. Markkula Dec. at ¶19. The increasing competition in the small computer market has only compounded this concern. Carter Dec. at ¶9; Markkula Dec. at ¶19.

Mail order sales, by definition, are unsupported. When a consumer orders through the mail, the mail order dealer has not evaluated the consumer's needs, nor provided the consumer with supervised "hands-on" computer experience, nor given the consumer the face-to-face orientation and instruction in the operation and applications of the computer so that the consumer can apply the computer to his problems. In addition, the seller is not in a position to help the consumer when he encounters problems. In short, the mail order dealer is either indifferent to the fact that consumers purchasing by mail have no support, or counts on other dealers to provide that support. Carter Dec. at ¶27; Markkula Dec. at ¶25.

A dealer who provides proper support for each sale incurs considerably higher costs than a dealer who does not. Rosen Dec. at ¶11; Michael Burwen Aff. at ¶14; Markkula Dec. at ¶13. Full-support dealers will not continue to provide support if this practice only increases their costs and works against them in the marketplace by putting them at a competitive disadvantage. Unless Apple requires each of its dealers to provide support, then, none will, and Apple will be at a serious competitive disadvantage as compared with large companies that have the in-house capability to provide support. Rosen Dec. at ¶11; Carter Dec. at ¶25.

E. The Mail Order Prohibition

Even after months of analyzing the mail order problem, Markkula Dec. at ¶9, Apple did not move to prohibit the mail order sale of its products until it had confirmed its conclusions with a formal investigation. The investigation consisted of three steps: identifying the scope of the problem; determining the support costs borne by full-support dealers on which mail order sales were "free-riding"; and securing the advice of an independent industry analyst to evaluate the effect of continued mail order sales on Apple's business. Carter Dec. at ¶28.

Apple determined the extent to which its products were being sold mail order by, first, canvassing its national sales force for the names of dealers selling mail order and, second, reviewing national magazines to identify those dealers advertising the mail order sale of Apple products. Carter Dec. at ¶29. Apple employees, without disclosing their company affiliations, then attempted to mail order an Apple II Plus 48K computer from each dealer identified in this manner. Those dealers who accepted the order were considered to actually be engaging in the mail order sale of Apple products. The investigation revealed that only thirty-one dealers with sixty-nine authorized locations were selling Apple products by mail order. Prices charged by these dealers for the mail order sale of an Apple II Plus 48K computer ranged from $1079 to $1530, the full suggested retail price. Carter Dec. at ¶29.*

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* Apple employees, without disclosing their company affiliations, also walked into an authorized location of each of

[Footnote continued on next page.]

Apple retained a survey sampling and consulting firm with extensive experience in the personal computer industry, Palo Alto Management Group, Inc. ("PAMG"), to determine the support costs borne by non-mail order dealers. PAMG's research confirmed that dealers who do not engage in the mail order sale of Apple products spend approximately 13% of their gross revenues and roughly 1/3 to 1/2 of their total operating margins on costs associated with supporting the face-to-face sale of Apple products. Michael Burwen Aff. at ¶14 and Exh. C; Carter Dec. at ¶31.

Apple also retained a nationally recognized and widely respected small computer industry analyst, Benjamin M. Rosen, to assist the company in evaluating the PAMG report and the company's conclusions regarding mail order, and to advise the company on its future course of action. After reviewing the report and considering Apple's position in the industry, Mr. Rosen advised the company that mail order sales had an extremely erosive effect on Apple's dealer base and were inimical to Apple's ability to compete vigorously in the small computer industry. Carter Dec. at ¶32. Mr. Rosen recommended that Apple cease doing business with dealers who engaged in the mail order sale of its products. Rosen Dec. at ¶¶16-18; Carter Dec. at ¶32.

[Footnote continued from previous page.]

these mail order dealers and secured price quotations for the same Apple II Plus 48K computer as part of a face-to-face sales transaction. This "walk-in" shopping revealed that many of the mail order dealers charged less for the same Apple computer sold mail order than if it were purchased from the same dealer as part of a face-to-face sale. Carter Dec. at ¶30. Prices for a face-to-face purchase of an Apple II Plus 48K computer ranged from $1055 to $1530. Carter Dec. at ¶30.

On November 3, 1981, Apple mailed all of its authorized dealers Modifications of their Dealer Agreements and letters setting forth Apple's new policy. Carter Dec. at ¶34. The letter stated that every dealer who desired to remain an authorized Apple dealer would be required to agree, by signing the Modification, that he would not engage in the mail order sale of Apple products. The letter said that every dealer who returned a signed Modification by November 20, 1981, would continue to be an authorized Apple dealer. Those who did not would be assumed to have decided to terminate their relationships with Apple, and those terminations would be effective December 4, 1981. Carter Dec. at ¶35; Carter Dec. Exh. H.*

The program was implemented as stated in the letter. Every dealer who returned a signed Modification continued as an authorized Apple dealer, regardless of any other factor, including whether he previously engaged in the mail order sale of Apple products. Carter Dec. at ¶36. All of the dealers identified as engaging in mail order sales, including these six plaintiffs, returned signed Modifications. Carter Dec. at ¶¶37-38. By the express terms of these documents, the execution date for the mail order agreement with each plaintiff was the date Apple signed that plaintiff's Modification. Apple signed all of the modifications on or before the date of the temporary restraining order hearing, and, accordingly, the agreements were all binding as of that time. See Carter Dec. Exh. I-N.

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* Coincident with prohibiting the mail order sale of Apple products by its dealers, Apple discontinued an experimental program it had devised in April of 1981 to determine whether mail order sales of computer software could be properly supported on a remote basis. The program yielded unsatisfactory results, and Apple therefore decided to include software products in its prohibition of mail order sales. Markkula Dec. at ¶20.

In November of 1981, Apple distributed to each of its dealers a notice that Apple would no longer sell software by mail order. Markkula Dec. at ¶20. Although plaintiffs received this mailing long before the hearing on December 4, they nevertheless represented to the Court that Apple was itself currently selling software by mail order. See "Summary of Facts in Support of Preliminary Injunction" at 3.

On December 4, 1981, plaintiffs moved this Court for a temporary restraining order, seeking to enjoin Apple from implementation of its mail order Modification. The Court denied that request, finding that "there is not sufficient showing of irreparable harm for the issuance of a temporary restraining order at this time or the likelihood of success on the merits." Transcript of Proceedings, Dec. 4, 1981, at 27.

ARGUMENT

PLAINTIFFS CLEARLY FAIL TO SATISFY THE REQUIREMENTS FOR THE GRANTING OF A PRELIMINARY INJUNCTION.

Plaintiffs in this case seek relief under the Clayton Act. That statute provides for injunctive relief upon a showing that "the danger of irreparable loss or damage is immediate" under the same conditions and principles as applied generally by courts of equity. See 15 U.S.C. § 26. In the Ninth Circuit, as elsewhere, courts of equity treat a preliminary injunction as an extreme and drastic remedy which is available only in the most compelling circumstances. "The grant of a preliminary injunction is the exercise of an extremely far-reaching power not to be indulged in except in a case clearly warranting it." Sierra Club v. Hickel, 433 F.2d 24, 33 (9th Cir. 1970).

This case fails in every respect to warrant preliminary injunctive relief. Indeed, a preliminary injunction is wholly inappropriate given the present posture of the parties. A fundamental principle applied by courts of equity in this Circuit is that the basic function of a preliminary injunction is to preserve the status quo ante litem pending the determination of the action on the merits. Los Angeles Memorial Coliseum Commission v. National Football League, 634 F.2d 1197, 1200 (9th Cir. 1980); Larry P. v. Riles, 502 F.2d 963, 965 (9th Cir. 1974); Washington Capitols Basketball Club, Inc. v. Barry, 419 F.2d 472, 476 (9th Cir. 1969). Prior to the filing of this lawsuit, all six plaintiffs signed contractual commitments requiring them to refrain from the mail and telephone order of Apple products. Carter Dec. at ¶38. By their express language, those contracts became effective, binding, and enforceable on dates prior to the initiation of these proceedings. Carter Dec. Exh. I through N. In other words, under the status quo ante litem, plaintiffs are precluded by their own contractual undertakings from the mail order sale of Apple products. The relief sought by plaintiffs would not restore the status quo; rather it would alter the business relationship among the parties. In effect, plaintiffs would have this Court issue a preliminary injunction to undo the contractual commitments they have made. We are aware of no case in which such relief has been granted.

Even assuming for purposes of this motion that a preliminary injunction would somehow restore the status quo in this case, the standards for granting a preliminary injunction under the Clayton Act preclude the award of such relief in this case. That statute, under which plaintiffs seek preliminary injunctive relief,* specifically requires a showing by plaintiffs that the "danger of irreparable loss or damage is immediate," 15 U.S.C. § 26. In addition, plaintiffs must satisfy the "same conditions and principles" that courts of equity apply in evaluating requests for preliminary injunctive relief. Id. In the Ninth Circuit, the traditional equitable standards for granting preliminary injunctive relief are:

1. A strong likelihood of success on the merits;
2. Irreparable injury to plaintiff if the preliminary relief is not granted; and
3. A balance of hardships favoring the plaintiff.

Los Angeles Memorial Coliseum Commissioner v. National Football League, 634 F.2d 1197, 1200 (9th Cir. 1980); Sierra Club v. Hathaway, 579 F.2d 1162, 1167 (9th Cir. 1978).

By failing to explain fully the standard for preliminary injunctive relief in the Ninth Circuit and by citing a district court opinion which was reversed by the Court of Appeals in 1980, plaintiffs in their motion papers invite this court to err. Citing William Inglis & Sons Baking Co. v. ITT Continental Baking Co., 526 F.2d 86 (9th Cir. 1975), and the lower court opinion in the Los Angeles Coliseum case (484

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* Plaintiffs' "Points and Authorities in Favor of Preliminary Injunction," at 2.

F. Supp. 124), plaintiffs' papers leave the reader with the distinct impression that there are two alternative standards that plaintiffs may satisfy to qualify for preliminary injunctive relief.* This is simply incorrect. Precedents more recent than Inglis have explained that there is, in fact, only one set of criteria for preliminary injunctive relief.

In reversing the district court opinion cited by plaintiffs the Ninth Circuit noted that:

> The moving party may meet its burden by demonstrating either (1) a combination of probable success on the merits and the possibility of irreparable injury or (2) that serious questions are raised and the balance of hardship tips sharply in its favor.... These are not separate tests but the outer reaches 'of a single continuum'.

Los Angeles Memorial Coliseum Commission v. National Football League, 634 F.2d 1197, 1201 (9th Cir. 1980). In the Ninth Circuit's words, Inglis "clarified" the burden carried by the moving party, but did not eliminate the traditional standards. Thus, the court concluded,

> Traditional standards for granting a preliminary injunction imposed a duty on the court to balance the interests of all parties and weigh the damage to each, mindful of the moving party's burden to show the possibility of ir-

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* Plaintiffs' "Points and Authorities in Favor of Preliminary Injunction," at 60-62.

> reparable injury to itself and the probability of success on the merits.

Id. at 1203.*

In order to qualify for preliminary injunctive relief, plaintiff must satisfy each of the prerequisites. *See*, *e.g.*, *Fox Valley Harvestore v. A. O. Smith Harvestore Prod.*, 545 F.2d 1096, 1097 (7th Cir. 1976). Plaintiffs have failed to satisfy even a single one of the criteria enunciated in the *Los Angeles Coliseum* case.

A. *Plaintiffs Are Unable to Show Irreparable Injury.*

1. *Plaintiffs' Damages Are Entirely Monetary and Alternative Products are Readily Available.*

On December 4, 1981, at the hearing on plaintiffs' motion for a temporary restraining order, the Court, after reading the plaintiffs' voluminous submission and hearing oral argument for more than an hour, denied plaintiffs' request. During oral argument the Court noted the absence of any showing of irreparable injury.* The facts have not changed in the intervening days. Noticeably missing from plaintiffs' submission is any corroboration for the unsupported assertion that plaintiffs will suffer irreparable injury as a result of Apple's mail order policy. The absence of any such showing is quite predictable -- under the established case law, plaintiffs are simply unable to make the necessary showing of irreparable injury. On the contrary, the extent of plaintiffs' injuries can be readily expressed in monetary damages -- particularly since courts regularly allow broad latitude in establishing damages in private antitrust actions. See, e.g., Jack Kahn Music Co. v. Baldwin Piano & Organ Co., 604 F.2d 755, 763 (2d Cir. 1979); Triebwasser & Katz v. A T & T Co., 535 F.2d 1356, 1359 (2d Cir. 1976).

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* The current Ninth Circuit standards are therefore in accord with the prevailing case law. *See*, *e.g.*, *Fox Valley Harvestore, Inc. v. A. O. Smith Harvestore Prod. Inc.*, 545 F.2d 1096 (7th Cir. 1976); *Planned Parenthood League of Mass. v. Bellotti*, 641 F.2d 1006 (1st Cir. 1981). The apparent adoption of an alternate test in the *Inglis* case was based upon the then-current standard in the Second Circuit--a standard which was first enunciated in *Sonesta International Hotels Corp. v. Wellington Associates*, 483 F.2d 247 (2d Cir. 1973). *See* *William Inglis & Sons Baking Co. v. ITT Continental Baking Co.*, 527 F.2d 86 (9th Cir.1975). The *Sonesta* standard was harshly criticized, *see*, *e.g.*, Mulligan, *Preliminary Injunctions in the Second Circuit*, 43 Brooklyn L. Rev.(1977), and largely abandoned even in the Second Circuit. *See*, *e.g.*, *Caulfield v. Board of Ed.*, 583 F.2d 605 (2d Cir. 1978). The Ninth Circuit's clarification of *Inglis* and the *Los Angeles Coliseum* case, then, brings this circuit's case law back into line with prevailing precedent elsewhere.

Plaintiffs' memorandum of "Points and Authorities in Favor of Preliminary Injunction" (hereinafter "Points and Authorities") lists the dollar volume of Apple products each plaintiff claims to have purchased in the past year. See, Points and Authorities at 9.** Plaintiffs apparently contend that they will be injured to the extent of their total purchases. This assertion was based on the erroneous assumption that plaintiffs would be terminated by Apple as of December 4, 1981, as a result of Apple's mail order policy. In point of fact, since each of the plaintiff's executed its respective contract modification prior to November 20, none of the plaintiffs were terminated. However, the contract modifications prohibit plaintiffs from selling Apple products mail order. The extent of plaintiffs' injuries, then, are the sales plaintiffs would have made via mail and telephone order but for Apple's mail order policy, which prevents them from doing so.

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* The court stated: "Based upon the documents that have been submitted to the Court, the argument of counsel this afternoon, the Court would deny the request for issuance of the temporary restraining order and would find that there is not a sufficient showing of irreparable harm for the issuance of a temporary restraining order at this time or the likelihood of success on the merits." Transcript of Proceedings, Dec. 4, 1981 at 27.

** The rather large percentage of business these plaintiffs attribute to Apple is inconsistent with the percentage of Apple products indicated in plaintiffs' advertising. For example, all four of these plaintiffs have large mail order advertisements in the December issue of Byte magazine, the leading national computer magazine. Of the approximately 1180 items advertised by plaintiff Advanced Computer

[Footnote text on next page.]

The precise amount of damages each plaintiff suffered can be calculated readily. Plaintiffs need only keep track of the orders customers attempt to place via mail or telephone order. Alternatively, plaintiffs might determine the percentage of sales of Apple products sold via telephone and mail order in the past year, and use this percentage to estimate sales lost as a result of the contract modification.*

[Footnote continued from previous page.]

Products, only 14 sold exclusively by Apple. Similarly, of the 99 items Olympic Sales Co. advertised, only 9 are sold exclusively by Apple; Consumer Computer advertised 245 items, of which 39 are sold exclusively by Apple; Computer Exchange advertised 103, of which Apple sells 18 exclusively; Computer Specialties advertised 116, of which Apple sells but 3 exclusively; and Micro Business World advertised 133, of which Apple sells but 11 exclusively. Doherty Dec. at ¶¶19-24.

* Plaintiffs should experience no difficult in determining the mail order percentage of their sales of Apple products. Indeed, plaintiffs' declarations appended to their memorandum include such estimates. See O'Donnell Dec. at 8.

Whatever the extent of lost sales, plaintiffs' injuries are but monetary injuries which can be remedied fully by a damage award. They are in no sense irreparable. As the Supreme Court stated:

> The key word in this consideration is irreparable. Mere injuries, however substantial, in terms of money, time and energy necessarily expended in the absence of a stay, are not enough. The possibility that adequate compensatory or other corrective relief will be available at a later date, in the ordinary course of litigation, weighs heavily against a claim of irreparable harm.

Sampson v. Murray, 415 U.S. 61, 90 (1974).

In accordance with the Supreme Court's directive, the Ninth Circuit has ruled that since loss of revenue and loss of goodwill are compensable by an award of damages, they are simply not irreparable injuries. Los Angeles Memorial Coliseum, 634 F.2d 1197, 1202-1203 (9th Cir. 1980).

Indeed, under the established precedent of this Court, plaintiffs would suffer no irreparable injury, even if Apple terminated its entire business relationship with them. In McGuire v. Times Mirror Co., 405 F. Supp. 57 (C.D. Cal. 1975), for example, the defendant terminated its entire outside distribution network in favor of vertically integrating to satisfy distribution needs with company employees. The terminated distributors sought a preliminary injunction, but the court denied plaintiffs' request on a number of grounds, including the fact that the harm suffered by the terminated distributors was fully compensable in monetary damages. Accord, Hardin v. Houston Chronicle Publishing Co., 426 F. Supp. 1114 (S.D. Tex. 1977), aff'd, 572 F.2d 1106 (5th Cir. 1978). Furthermore, since plaintiffs in this case are operating under dealership contracts which are terminable at will by Apple on thirty (30) days' notice, they can hardly claim irreparable injury for what is clearly a foreseeable business risk.

> Since the contract under which plaintiffs were operating their business was terminable at will...and there was no discrimination in the terminations, the terminations were a foreseeable risk of doing business. The Court, therefore, finds that the plaintiffs have failed to show irreparable injury.

Hardin v. Houston Chronicle Publishing Co., 434 F.Supp. 54, 57 (S.D. Tex. 1977), aff'd, 572 F.2d 1106 (5th Cir. 1978).

Finally, in order to establish irreparable injury, plaintiffs must demonstrate the absence of alternative sources of small computers which can be mail ordered. Plaintiffs' own assertions belie any such representation. The plaintiffs themselves aver that they sell, via mail and telephone order, small computers which are comparable to those of Apple. See, Ravel Dec. at 2. Accordingly, the availability of computer products which can be mail ordered eviscerates any claim of irreparable injury. Los Angeles Coliseum, 634 F.2d at 1202-03; Triebwasser & Katz v. AT&T, 535 F.2d 1356, 1360 (2d Cir.1976); Virginia Automotive, Ltd. v. Kanair Corp., 393 F.2d 126, 128 (4th Cir. 1968); Bridgeport Convertibles, Inc. v. Castro Convertible

Corp., 1978-1 Trade Cas. ¶61,954 at 74,040-41 (S.D.N.Y.1978).

2. Plaintiffs Will Not Suffer Any Injury as a Consequence of Outstanding Commitments.

Plaintiffs' assertion that they will suffer irreparable injury because of an inability to satisfy mail and telephone order commitments made prior to November 2, 1981, is a mere makeweight. Two of the plaintiffs claimed that they have published mail order catalogs and consequently must honor any orders placed for items displayed in the catalogs. This argument is entirely specious. All of these plaintiffs knew far in advance of their catalog publication dates that Apple intended to prohibit the mail order sales of its products.

For example, Richard J. Clardy, the major partner of Consumer Computers admits that he was told in March of 1981 that Apple would not permit the mail order sale of its products. Likewise, David Freeman, President of Advanced Computer Products, avers that he has published a catalog displaying Apple products, Freeman Dec. at 12, but fails to mention that Advanced Computer Products was specifically informed by letter of April 24, 1981, that Apple would not permit the mail order sale of its products. See Markkula Dec. Exh. J. And Francis Ravel alleges that Olympic Sales published and distributed a catalog in October. Ravel Dec. at 1. Ravel omits mentioning the fact that he was informed prior to June, 1981, long before publication of his catalog, that he would have to cease mail order sales of Apple products if he wished to remain an authorized Apple dealer. Markkula Dec. at ¶28. Obviously, plaintiffs cannot claim irreparable injury for a situation that they themselves created despite forewarning by Apple.

Furthermore, plaintiffs implicitly suggest that they must honor the prices and terms quoted in their catalogs. This is fallacious. Publication of a catalog or advertisement of a product does not constitute an offer to sell, but merely a solicitation of offers from prospective customers. Plaintiffs may, therefore, refuse to accept any orders for Apple products because of changed conditions. *See* 1 B. Witkin, *Summary of California Law* § 99 (8th Ed. 1973); A. Corbin, *Corbin on Contracts* § 28 (1952); L. Simpson, *Handbook of the Law of Contracts* § 15 (2d Ed. 1965). Indeed, plaintiffs have consistently interpreted their catalogs as nothing more than solicitations for offers.* In any event, plaintiffs need only send out a mailing to catalog recipients announcing that Apple products will no longer be sold via telephone and mail order in order to avoid misunderstandings on the part of consumers.

Plaintiffs' assertions with respect to outstanding bids are also without merit. The declaration of Francis Ravel states, for example, that at the present time Olympic Sales has bids outstanding to school districts, universities, and the like. Ravel Dec. at 2. The declaration contains no assertion, however, that any such bids have been accepted. Instead, it says only that, "If we do what Apple wants, we have to breach our own contract *with people who accept our bids*," (emphasis supplied). In other words, there are no contracts at the present time, and there is, then, no reason why these bids cannot be withdrawn. None of the plaintiffs have presented any hard evidence in the form of actual contracts indicating that they have outstanding commitments.

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* Indeed Olympic Sales mail order catalogue bears the disclaimer, "All goods are subject to availability and all prices are subject to change without notice."

Even if there were binding bid contracts, Apple's modification would not prohibit performance under those contracts. The modification requires only that sales of Apple products be properly supported. In the case of a bid to a school district, for example, the consumers needing face-to-face instruction and supervised "hands-on" computer experience are the school teachers who will actually be using the computer systems. Personal contact between the selling dealer and the school teachers is, therefore, essential. If the school district has trainers or supervisors whose job it is to familiarize teachers with computer products so that they can be properly used in the classroom, the selling dealer can fulfill his support responsibilities by "training the trainers" -- i.e., providing the same kind of face-to-face instruction, supervised "hands-on" experience and the like that the dealer would provide for any other walk-in customer-- and by making himself readily available to answer questions and solve problems whenever they arise. Of course, it may be necessary for the dealer to have additional face-to-face sessions to resolve post-sale problems adequately, and the selling dealer should be prepared to provide this support.

In sum, plaintiffs have failed to demonstrate irreparable injury for at least three reasons. First, their damages are merely lost revenues and perhaps goodwill, both of which can be fully compensated with an award of monetary damages. Second, since the contracts between plaintiffs and defendant are terminable at will, complete termination is a foreseeable business risk. Finally, alternative sources of comparable goods are readily available to plaintiffs. In the case of catalog and bid sales, plaintiffs have failed to make a showing that they will be injured at all.

B. The Balance of Hardships Tips Decidedly Toward Apple.

In order to qualify for a preliminary injunction, plaintiffs must not only show irreparable injury. They must also demonstrate that their own injury in the absence of injunctive relief outweighs the harm which a preliminary injunction might cause to the defendant. Los Angeles Memorial Coliseum Commission v. National Football League, 634 F.2d 1197, 1203 (9th Cir. 1980). In the absence of preliminary injunctive relief, plaintiffs will suffer only loss of revenues for which they can be fully compensated by an award of monetary damages. If, on the other hand, the preliminary injunction is granted, Apple will be severely and irreparably injured. Markkula Dec. at ¶21-22; Rosen Dec. at ¶15.

Far more is at stake in this litigation than in the "ordinary" dealer termination case, in which only the relationship between the parties before the court is affected by the court's ruling on preliminary injunctive relief. Granting the relief sought in this case would not merely affect Apple's relationship with these six plaintiffs. Rather, it would disrupt Apple's entire national distribution network for computer products during the most crucial period in the company's brief history. In other words, if this Court grants preliminary injunctive relief, Apple will be forced to abandon on a nationwide basis its entire program for preventing mail order sales. There is simply no way Apple could require its other dealers (numbering approximately 1,000 in the United States) to refrain from the mail order sale of its products if these plaintiffs are permitted to engage in such sales.

Failure to prohibit mail order sales in the coming months could have disastrous consequences for the company. As has been described in some detail (supra at 3), a myriad of companies compete in the small computer market. Rosen Dec. at ¶5. Within the last few months, Apple has begun to face competition from multinational giants such as Xerox and IBM. Id. These companies, as well as Tandy (Radio Shack), have fully developed national sales networks that provide a direct interface between the manufacturer and the consumer. Id at ¶6. Apple, of course, must rely upon its independent dealers to provide the necessary support. Naturally, a dealer providing proper support is going to incur considerably higher operating costs for each sale. Unless Apple can require all of its dealers to provide pre- and post-sale support, none will have the incentive to do so, and Apple will be at a serious competitive disadvantage, as compared with those large companies that have the "in house" capability to provide adequate support. Rosen Dec. at ¶11.

Furthermore, the ramifications of granting the relief sought go beyond consumer dissatisfaction with improperly supported Apple products and the attendant loss in Apple's market position. Failure to prohibit mail order sales will have an immediate discernible erosive effect on the independent dealer base upon which Apple depends for its existence. As part of the company's consideration of its mail order policy, Apple sought the counsel of Benjamin M. Rosen, a nationally recognized expert in the electronics and small computer field. Carter Dec. at ¶ 32; Rosen Dec. at ¶¶1-4. Mr. Rosen advised Apple that dealers who provide support for all sales regard mail order sellers as "free riding" on the provision of support by non-mail order dealers. Rosen Dec. at ¶13. Therefore, according to Mr. Rosen, prior to the announcement of Apple's mail order policy, dealers had indicated an intention to reduce their sales of Apple products in favor of competitor's products because Apple had done nothing about the unsupported mail order sale of its products. Id. In other words, dealers were unwilling to continue incurring the costs of providing support for all sales when it only worked against them in the marketplace.

Mr. Rosen therefore advised Apple that failure to take action prohibiting mail order sales would cause dealers to turn their attention from Apple to its competitors at a time when, because of recent entrants into the small computer market, dealers will be deciding whether to continue promoting Apple's computers or switching to IBM, Xerox or other available brands. Id. at ¶¶12-13. Accordingly, if Apple is unable to enforce its mail order policy, competitors will become entrenched in the independent dealer network at Apple's expense and the company's long term prospects will be damaged to an incalculable extent. Id. at ¶14.

In the final analysis, the transitory injury that plaintiffs will suffer (for which they will be fully compensated if they prevail in this litigation) pales in comparison to the irreparable damage that Apple will incur if the company is enjoined from enforcing its mail order policy. The damage that would occur to both Apple's immediate and long-term position could not be rectified, even if Apple ultimately prevails on the merits.

C. Plaintiffs Have Absolutely No Chance Whatever of Prevailing on the Merits.

Of the three criteria that plaintiffs must satisfy in order to warrant preliminary injunctive relief, they have failed most clearly to demonstrate a probability of success on the merits. Indeed, when Apple's full support, mail order policy is considered in light of recent antitrust precedent, it can safely be said that plaintiffs can demonstrate no chance at all of success on the merits.

1. Plaintiffs Have Mischaracterized the Effect of the Mail Order Modification.

In order to avoid the clear result under the case law, plaintiffs seek to characterize themselves as "discounters" and the mail order restriction as a program to eliminate price competition. Points and Authorities at 13. These characterizations are simply incorrect. Neither these plaintiffs nor the dealers as a group who sell Apple products mail order can accurately be described as discounters. In point of fact, there are dealers, including dealers in Southern California, who sell Apple products in person-to-person fully supported sales at prices lower than these plaintiffs sell the same products via mail order. Carter Dec. at ¶30. Indeed, these plaintiffs cite one such example in their own submission. Plaintiffs' Exh. 20. The contract modification these plaintiffs seek to enjoin will in no way prohibit dealers from selling at these low prices in face-to-face fully supported sales -- the modification is simply not addressed to that issue at all.

Conversely, there are dealers who have engaged in the mail order sale of Apple products at the full suggested resale price. Carter Dec. at ¶29. These dealers have signed the contract modification and will in the future be precluded from making such sales. Carter Dec. at ¶¶ 29,38. In other words, even though the sales are made at a relatively "high" price, they are offensive to Apple and violate the contract modification because they are unsupported by face-to-face instruction and supervised "hands on" computer experience. Even the most cursory analysis, then, reveals that the mail order contract modification does not conform to plaintiffs' characterization -- the modification clearly permits sales at so-called "discount" prices if they are fully supported, and prohibits sales at even the "highest" prices if they are made via telephone or mail order.

Plaintiffs' argument that Apple's mail order prohibition, or for that matter, any other aspect of the company's full support policy is directed toward inhibiting dealer sales at "discount" levels is at variance with the facts. Apple has a cooperative advertising program under which dealers are reimbursed in the form of a cooperative allowance for advertising Apple products. Carter Dec. at ¶22. All advertisements which properly display Apple products qualify for the allowance, regardless of the price specified in the ad itself. Carter Dec. at ¶22. Although it would be entirely legal for Apple to reimburse only those dealers who advertise at the full suggested retail price, see In re Nissan Antitrust Litigation, 577 F.2d 910 (5th Cir. 1978), cert. denied 439 U.S. 1072 (1979), the company has not imposed any such requirement. In other words, far from dissuading dealers from selling at "low" prices, Apple has contributed money toward advertisements which display Apple products at prices lower than those charged by these plaintiffs.

2. Apple's mail order prohibition is a vertical, non-price restriction which should be analyzed under the "rule of reason."

Since Apple's mail order prohibition is imposed by the manufacturer, it is, in antitrust parlance, a "vertical" restriction. Since the prohibition applies without regard to the price charged by the dealer, it is a "non-price" restriction. As evidenced by cases such as White Motor Co. v. United States, 372 U.S. 253 (1963), vertical non-price restrictions were historically judged under the "rule of reason" -- that is, in the words of Justice Brandeis, in Chicago Board of Trade v. United States, 246 U.S. 231 (1918), the test of legality depends upon whether the restriction inhibits competition:

> To determine that question, the court must ordinarily consider the facts peculiar to the business to which the restraint is applied; its condition before and after the restraint was imposed; the nature of the restraint and its effect, actual or probable. The history of the restraint,the evil believed to exist, the reason for adopting the particular remedy, the purpose or end sought to be attained, are all relevant facts.

Id. at 238.

In 1967, the Supreme Court reversed its position and declared, in United States v. Arnold, Schwinn & Co., 388 U.S. 365 (1967), that all vertical non-price restrictions were "illegal per se." The court stated that vertical non-price restrictions should be grouped with horizontal restraints (i.e., conspiracies among competitors) and vertical price-fixing and therefore "conclusively presumed to be unreasonable and therefore illegal without elaborate inquiry as to the precise harm they have caused or the business excuse for their use." Northern Pacific Railroad Co. v. United States, 356 U.S. 1, 5 (1958).

The Supreme Court ruling created considerable controversy. Legal scholars, in particular, argued that although vertical restrictions inhibited intrabrand competition, they generally promoted interbrand competition and thereby enhanced consumer welfare.* The Supreme Court subsequently acknowledged its error and expressly overruled Schwinn in Continental T.V., Inc. v. GTE Sylvania, Inc., 433 U.S. 36 (1977), reaffirming the principle that vertical non-price restrictions are to be judged by the rule of reason. Applying Sylvania, the lower courts well-nigh without exception, have upheld vertical non-price restrictions as reasonable business practices. (See infra pp.34-49). Indeed, the proposition that the economic system generally and consumers in particular benefit from vertical restrictions is so widely supported that top officials of the Antitrust Division have repeatedly endorsed the legality of such restraints.**

In Sylvania, the Supreme Court upheld a vertical territorial restriction -- the manufacturer's right to require each of its authorized dealers to sell the manufacturer's product only from the location at which the dealer was authorized. According to the Court, although this restriction impeded intrabrand competition among Sylvania authorized dealers, it improved interbrand competition by increasing Sylvania's market share and thereby making it a more formidable competitor. The Court declared that "interbrand competition is the primary concern of the antitrust laws," Continental T.V., Inc. v. GTE Sylvania, Inc., 433 U.S. 36, 51 n. 19 (1977), and expressly recognized several legitimate business justifications for the imposition of vertical restrictions, including the elimination of "free riders."

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* See, e.g., Posner, The Rule of Reason and the Economic Approach, 45 U. Chi. L. Rev. 1 (1977); Strasser, Vertical Territorial Restraints after Sylvania, 1977 Duke L. J. 775 (1977); Posner, The Next Step in the Antitrust Treatment of Restricted Distribution: Per Se Legality, 48 U. Chi. L. Rev. 6 (1981).

** See, e.g., Trade Reg. Rep. (CCH) No. 516 at 4 (Nov. 16, 1981) (Ronald G. Carr, Deputy Assistant Attorney General, Antitrust Division); Trade Reg. Rep. (CCH) No. 496 at 6 (Jun. 30, 1981) (William French Smith, Attorney General); Trade Reg. Rep. (CCH) No. 498 at 2 (July 13, 1981) (William F. Baxter, Assistant Attorney General); Trade Reg. Rep. (CCH) No. 509 at 3 (Sept. 29, 1981) (Richard J. Favretto, Deputy Assistant Attorney General, Antitrust Division).

> Established manufacturers can use [vertical non-price restrictions] to induce retailers to engage in promotional activities or to provide service and repair facilities necessary to the efficient marketing of their products.... The availability and quality of such services affect a manufacturer's goodwill and the competitiveness of his product. Because of market imperfections such as the so-called "free rider" effect, these services might not be provided by retailers in a purely competive situation, despite the fact that each retailer's benefit would be greater if all provided the services than if none did.

Id. at 55.

In the wake of Sylvania, the lower courts have looked principally to two criteria in evaluating the vertical restrictions under the rule of reason: (1) the effect of the restriction on interbrand competition, and (2) the business justification proffered by the manufacturer for the restriction. See, e.g., Muenster Butane, Inc. v. Stewart Co., 651 F.2d 292 (5th Cir. 1981); Cowley v. Braden Industries, Inc., 613 F.2d 751 (9th

Cir. 1980), cert. denied, 446 U.S. 965 (1980); Kestenbaum v. Falstaff Brewing Corp., 575 F.2d 654 (5th Cir. 1978). Application of these criteria to the small computer market conclusively demonstrates that under the rule of reason, Apple's mail order policy is lawful.

(a) The presence of vigorous competition and the absence of market power conclusively establishes the legality of Apple's mail order restrictions.

(i) Market power

In order to evaluate the effect of vertical restrictions on interbrand competition, courts consider both the extent of interbrand competition prevailing in the market and whether the manufacturer's restriction will inhibit this competition. See, e.g., Muenster Butane, Inc. v. Stewart Co. 651 F.2d 292 (5th Cir. 1981); Red Diamond Supply, Inc. v. Liquid Carbonic Corp., 637 F.2d 1001 (5th Cir. 1981), cert. denied, 50 U.S.L.W. 3246 (U.S. Oct. 6, 1981); Cowley v. Braden Industries, Inc., 613 F.2d 751 (9th Cir.), cert. denied, 446 U.S. 965 (1980). The presence of vigorous interbrand competition necessarily dictates the conclusion that the manufacturer's restriction is reasonable and therefore legal, since, in the Supreme Court's words,

> [w]hen interbrand competition exists...it provides a significant check on the exploitation of intrabrand market power because of the ability of consumers to substitute a different brand of the same product.

Continental T.V., Inc. v. GTE Sylvania, Inc., 433 U.S. 36, 51 n. 19 (1977).

Stated another way, only if a manufacturer so dominates a market as to exert substantial monopoly or market power -- the power to control price in the interbrand market -- is there any danger of harm to competition from a vertical intrabrand restriction. See, e.g., Muenster Butane, Inc. v. Stewart Co., 651 F.2d 292, 298 (5th Cir. 1981); Red Diamond Supply Co., Inc. v. Liquid Carbonic Corp., 637 F.2d 1001 (5th Cir. 1981), cert. denied, 50 U.S.L.W. 3246 (U.S. Oct.6, 1981).

The market in which Apple competes is extremely broad and therefore difficult to delineate with specificity. Under the seminal test for defining a relevant market enunciated in United States v. E.I. du Pont de Nemours & Co. (the Cellophane Case), 351 U.S. 377 (1956), the relevant market for an antitrust analysis includes all "commodities reasonably interchangeable by consumers for the same purposes," id. at 395. This definition has been applied in cases analyzing a myriad of industries, see e.g., Yoder Bros. v. California-Florida Plant Corp. 537 F.2d 1347, 1367 (5th Cir. 1976), cert. denied 429 U.S. 1094 (1977), including markets in complex technologies, see, e.g., Sargent-Welch Scientific Co. v. Ventron Corp., 1976-2 Trade cas. ¶61,146 (N.D.Ill.1976); Elco Corp. v. Microdot,Inc., 360 F.Supp.741 (D. Del. 1973). The definition has even been applied in antitrust analyses of the computer industry. See, e.g., Kaplan v. Burroughs Corp., 611 F.2d 286 (9th Cir. 1979), cert. denied, 447 U.S. 924 (1980); In re Data General Antitrust Litigation, Opinion and Order (N.D. Cal. Oct. 28, 1981).

In the only antitrust case that has analyzed the market in which Apple competes, In re Data General Antitrust Litigation, Opinion and Order (N.D. Cal. Oct. 28, 1981), the court applied the definition of "reasonable interchangeability for the same or similar uses," slip op. at 11, and concluded that the relevant market included "all general purpose minicomputers and microprocessors," id. at 17, which according to the court, range in price from $300 to $20,000, id. at 10. The court reached this conclusion reasoning that the numerous manufacturers in this market were all offering general-purpose solutions to meet end-user needs for a broad variety of applications and, hence, were providing the identical or equivalent services to potential customers. Id. at 18. Applying the Data General market definition to this case, Apple's share of the relevant market is less than 6%. Rosen Dec. at ¶4.

(ii) Vigorous interbrand competition

Regardless of the precise manner in which the market in this case is defined or Apple's exact percentage share of that market, it is indisputable -- and, indeed, undisputed by these plaintiffs -- that the market is characterized by keen competition and ease of entry. See Rosen Dec. at ¶5; Fenwick Dec. Exh. A. More than twenty firms manufacture small computer systems in competition with Apple products. Rosen Dec. at ¶5. Ten new entrants, including some of the world's largest corporations, began to manufacture and distribute small computer systems since the beginning of this year alone. This trend is expected to continue for the foreseeable future, and Apple will therefore have to continue cutting its costs and decreasing its prices in order to remain a viable competitor in this market. Rosen Dec. at ¶5.

Courts have repeatedly upheld vertical restrictions in markets characterized by greater concentration and considerably less competition than is present in the small computer market under any reasonable definition of that market.* In sum, the presence of competition in the small computer market, and the undisputed fact that Apple lacks market power, justify Apple's mail order prohibition under prevailing case law, without regard to any other consideration. See Muenster Butane, Inc. v. Stewart Co., 651 F.2d 292 (5th Cir. 1981); JBL Enterprises, Inc. v. Jhirmack Enterprises, Inc., 519 F.Supp. 1084 (N.D. Cal. 1981).

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*In Northwest Power Products, Inc. v. Omark Industries, Inc., 576 F.2d 83 (5th Cir. 1978), cert. denied, 439 U.S.1116 (1979), the defendant had a 25% share and the second largest position in the market consisting of nine companies, but the court found that the manufacturer's conduct in terminating a distributor did not run afoul of the rule of reason. Similarly, in Red Diamond Supply, Inc. v. Liquid Carbonic Corp., 637 F.2d 1001 (5th Cir. 1981), cert. denied, 50 U.S.L.W. 3246 (U.S. Oct. 6, 1981), the defendant, accused of conspiring with its distributors to maintain territorial and customer restrictions, was one of only seven manufacturers in the relevant market, but the court found no violation of the rule of reason because the restraints were not shown to have an adverse effect on interbrand competition.

The defendant in Cowley v. Braden Industries, Inc., 613 F.2d 751 (9th Cir. 1980), cert. denied, 446 U.S. 965 (1980), had approximately 70% of the relevant market and imposed restrictions which impeded its distributors from selling outside their assigned territories. The court, however, rejected the argument that defendant's market share caused the intrabrand restriction to violate the rule of reason. Finally, in Rice Tire Co. v. Michelin Tire Corp., 483 F.Supp. 750 (D. Md. 1980), aff'd, 638 F.2d 15 (4th Cir. 1981), cert. denied, 50 U.S.L.W. 3248 (U.S. Oct. 6, 1981), the defendant had an 8% share in one portion of the relevant market, and a 25% share in another, but its vertical restriction did not run afoul of the rule of reason because of the presence in the market of other large manufacturers and the fact that defendant had lowered its prices in response to competition. Id at 761.

Furthermore, Apple's mail order prohibition will only enhance the extent and quality of competition in the small computer market. If the prohibition is enjoined, Apple's ability to compete against the larger companies in the market will be severely and perhaps even irreparably damaged. Rosen Dec. at ¶15; Markkula Dec. at ¶¶21-22. Not only will Apple be unable to guarantee the same quality of consumer support that its vertically integrated competitors provide, but independent dealers will begin to promote competitor's products at Apple's expense, as well. Rosen Dec. ¶13,15. As a result, the small computer market could become dominated by the same companies that control other facets of the computer and data processing industries.* Conversely, any diminution in intrabrand competition caused by Apple's restriction will be minimal. Dealers will still be able to sell their products at whatever price they choose, so long as their sales are adequately supported.

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* If the injunction sought by plaintiffs is granted, Apple will be forced to consider forward vertical integration into computer retailing in order to guarantee that its products are not sold by mail order. Markkula Dec. at ¶22. Given the competitive nature of the small computer market and Apple's place in that market, forward integration by Apple would be entirely lawful. *See, e.g.*, *Red Diamond Supply, Inc. v. Liquid Carbonic Corp.*, 637 F.2d 1001, 1007 (5th Cir. 1978), *cert. denied*, 50 U.S.L.W. 3246 (U.S. Oct. 6, 1981); *Northwest Power Products, Inc. v. Omark Industries, Inc.*, 576 F.2d 83,89 (5th Cir. 1978), *cert. denied*, 439 U.S. 1116 (1979); *Associated Radio Service Co. v. Page Airways, Inc.*, 624 F.2d 1342, 1351 (5th Cir. 1980). Such forward integration would have a far greater impact on competition than Apple's mail order prohibition; indeed, it is predictable that vertical integration will cause the demise of countless independent computer dealers. See Markkula Dec. at ¶22. Accordingly, there is simply no logical or legal basis for prohibiting Apple from doing by contract what it could do by forward integration.

Competition among Apple dealers, then, should remain vigorous.*

(b) Apple's mail order prohibition is also supported by legitimate business justifications.

Even if a manufacturer has market power, the rule of reason nevertheless permits the manufacturer to impose vertical non-price restrictions if they are supported by legitimate business justifications. Two such justifications, explicitly approved under the rule of reason, are the provision of adequate customer support and the elimination of "free riders" in the manufacturer's distribution system. Thus, since Apple's mail order prohibition is specifically designed to address these concerns, Apple's contract modification would be entirely legal under the rule of reason even if the company had market power (which it does not) and even if the small computer market were not characterized by such keen competition (which it is).

(i) Provision of pre- and post-sale support

It was recognized even before the Sylvania decision that special consideration is to be given under the antitrust laws "when a manufacturer is selling a product to dealers which requires special pre- or post-sale service."

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* Plaintiffs' counsel has asserted that Apple's National Accounts Program will in some unexplained manner retard competition. "Summary of Facts in Support of Preliminary Injunction" at 6. This assertion borders on the ridiculous. As explained in detail in the affidavit of Joseph Roebuck, submitted herewith, the National Accounts Program enables Apple and its dealers to compete for business that would otherwise have gone to Apple's largest competitors. Furthermore, under the program, even the smallest dealer has the opportunity to sell to the world's largest corporations. Roebuck Dec. at ¶¶4,11. Markkula Dec. at ¶¶21-22.

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Mitchell v. U.S. Surgical Corp., 1976-1 Trade Cas. ¶60,879 (S.D. Ohio 1976). In that case, a dealer was terminated because he did not provide the customers (doctors) with face-to-face support in the use of instruments developed by the manufacturer. Plaintiff claimed that the manufacturer's territorial restrictions were an illegal restraint of trade, but the court held that since the product required special "pre- and post-sale service," the restraint was reasonable.

A manufacturer's legitimate interest in requiring dealers to provide adequate consumer support has been addressed in other cases as well. In Red Diamond Supply, Inc. v. Liquid Carbonic Corp., 637 F.2d 1001 (5th Cir. 1981), cert. denied, 50 U.S.L.W. 3246 (U.S. Oct. 6, 1981), the defendant, a manufacturer of industrial gas products, was sued by a distributor for imposing territorial and customer restrictions. The court nevertheless concluded that these restrictions were entirely lawful under the rule of reason because, among other things, the restrictions could have provided more effective customer service. Likewise, the Ninth Circuit has held in Golden Gate Accept. Corp. v. General Motors Corp., 597 F.2d 676 (9th Cir. 1979), that the defendant's termination of a dealer for failing to abide by a location clause in the dealer agreement was not an illegal restraint of trade because the clause was intended and enforced by the manufacturer as a method of assuring an effective network of qualified sales and service dealerships. Id. at 678 n.4. Finally, in Newberry v. The Washington Post Co., 438 F. Supp. 470 (D.D.C. 1977), a number of dealers attacked the territorial restrictions imposed by the defendant. Although the defendant was the only manufacturer in the market and, hence, a monopolist, the court held that the restrictions were reasonable because they were intended to promote prompt, efficient, and uninterrupted service to customers. Id. at 474-475.

Apple's mail order prohibition is entirely consistent with this line of authority. The small computer is an incredibly complicated device consisting of a number of components, including a central processing unit and peripherals. Markkula Dec. at ¶¶4-9. Thom Dec. at ¶¶2-31. There are few, if any, consumers who can operate a small computer, or even assemble a small computer system of the type a small business would purchase, without extensive face-to-face instruction.* Markkula Dec. at ¶¶4-9. Apple's mail order policy does nothing more than require the dealer to provide this face-to-face support with every sale. Under the case law, then, the mail order prohibition is a reasonable method of assuring adequate levels of customer service and support, and, hence, entirely lawful.

(ii) Elimination of free riders

In the Sylvania case, the Supreme Court indicated that vertical non-price restrictions may also be used to eliminate "free riders"-- dealers who do not themselves provide services necessary to preserve the competitiveness of the manufacturer's product, but "free ride" on the provision of those services by other dealers. Continental TV, Inc. v. GTE Sylvania, Inc., 433 U.S. 36,55 (1977). The lower courts have assiduously followed the Supreme Court's directive and recognized that the elimination of "free riders" is a legitimate business purpose which justifies vertical non-price restrictions under the rule of reason. Two lower court cases have specifically addressed this justification, Rice Tire Co. v. Michelin Tire Corp., 483 F. Supp. 750 (D. Md. 1980), aff'd, 638 F.2d 15 (4th Cir. 1981), cert. denied, 50 U.S.L.W. 3248 (U.S. Oct. 6, 1981), and Muenster Butane, Inc. v. Stewart Co., 651 F.2d 292 (5th Cir. 1981).

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* The unsupported assertion of plaintiffs' attorney that Apple's small computers are on the order of complexity of video games assembled by eight to ten year olds, "Summary of Facts in Support of Preliminary Injunction" at 7, only confirms that Mr. Horwich has never attempted to assemble an Apple computer system. The Declaration of Douglas S. Thom amply demonstrates the difficulties that a consumer would encounter in assembling a system of the type purchased by a businessman. Thom Dec. at ¶¶2-20.

The Rice Tire case is virtually identical to the fact situation before the court. Michelin, the defendant, pioneered the development of the radial tire, and at the time of the litigation had roughly an eight percent share of the radial passenger tire market and a 20-25% share of the radial truck tire market. Michelin, like Apple, had been forced to lower its prices because of competition from other manufacturers. Michelin's efforts to remain a leading company in the radial tire market were threatened by wholesalers and unauthorized dealers to whom wholesalers' sold free-riding on the promotional and service efforts provided by Michelin and its authorized dealers. In response to this problem, Michelin adopted an anti-wholesaling policy and a restriction that authorized dealers could sell Michelin tires only at locations at which they could provide services. Because Rice aggressively wholesaled Michelin tires, Michelin declined to renew Rice's distributorship. Rice brought suit, claiming the Michelin policies were illegal under the rule of reason.

The Rice Tire court's analysis speaks directly to this case. The court reasoned that unless Michelin terminated wholesalers, its authorized dealers would be unwilling to engage in an "efficient" amount of promotion for fear of being undersold by unauthorized dealers. The court's discussion of the fact that Rice was free riding on support services provided by other authorized dealers is even more telling. The court discussed extensively the important role of service in marketing Michelin tires. The court found that proper selection was particularly important in the truck tire market, and specialized knowledge was required in both segments of the radial tire market in order to provide repairing and retreading services. Thus, according to the court, Michelin had a legitimate interest in insuring that tires were sold by dealers who could adequately provide these specialized services. Id.

Michelin faced precisely the same problem now confronting Apple. Since unauthorized dealers were not obligated to provide these services, customers "presumably" (according to the court) went to authorized dealers to obtain these services, but subsequently purchased from unauthorized dealers because of their cheaper prices. Id. at 759. Hence, the court found that authorized dealers would not provide many of these services because incurring the costs associated with the services would permit unauthorized dealers who did not provide such support to undercut the authorized dealers in price. Recognizing a manufacturer's legitimate interest in imposing vertical restrictions to stimulate point of sales support, particularly in markets where it is difficult to prevent customers from obtaining support at one location while purchasing lower priced products at another location where support is not provided, the Rice Tire court concluded that Michelin's decision not to renew aggressive wholesalers was reasonably necessary to insure the provision of point of sale support. The restriction, therefore, was not an unreasonable restraint of trade.

The situation with respect to Apple's products is similarly characterized by free-riding. The investigation which Apple undertook prior to distributing the mail order modification demonstrably confirmed that Apple dealers who do not engage in the mail order sale of Apple products expend a very large percentage of their gross revenues (and, indeed, between a third and one-half their profits) on providing the support that is necessary to keep Apple competitive in the personal computer market. Michael Burwen Aff. at ¶14 and Exh. C. Such support includes face-to-face instruction with respect to the operation and applications of Apple's computers and continuing assistance in solving consumers' problems.

Mail order sales, on the other hand, are by definition unsupported. Carter Dec. at ¶27; Markkula Dec. at ¶18. The purchaser is not given instruction with respect to his computer, nor is the dealer available to resolve the customer's difficulties subsequent to the sale. Although these plaintiffs claim that they have qualified personnel, these personnel clearly only support sales to walk-in customers. As indicated in the affidavits submitted herewith, Apple personnel purchased computers mail order from each of the plaintiffs. The plaintiffs provided absolutely no support with respect to any of these sales. Indeed, several of the purchasers asked support-related questions in placing their orders with these plaintiffs and have never received any information with respect to those questions.*

There is no more telling evidence of this "free riding" than the prices the plaintiffs themselves charge for Apple products. Three of the six plaintiffs charge more-- in one case $450 more**-- for the same Apple products if they sell them through supported face-to-face sales, as opposed to unsupported mail order sales.*** This phenomenon is by no means limited to just these plaintiffs-- it was prevalent among all of the dealers who prior to December 4 engaged in the mail order sale of Apple products. See Carter Dec. at ¶23. This difference between what the same dealer charges for the supported sale of a product and the unsupported sale of the same product can be attributed only to the greater costs associated with fully supported sales. Dealers selling via mail order at lower prices are clearly "free riding" on the provision of support by others.

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* See, e.g., Soder Supp. Aff. at ¶7; Patterson Aff. at ¶7; Brookshire Aff. at ¶7; Patterson Supp. Aff. at ¶8, all submitted herewith. Indeed, none of these plaintiffs informed the Apple employee who purchased from them via mail order that it was necessary to purchase a disc drive in order to take advantage of the capabilities of the Apple computer which the shopper bought. Markkula Dec. at ¶18.

** Custom Computer sells an Apple II Plus 48K computer for $1530 in a fully-supported face-to-face sale, but sells the same computer for $1079 in an unsupported mail order sale. Compare Aff. of Dennis Smith with Aff. of Ken Soder.

*** Compare Supp. Aff. of T.J. Patterson with Aff. of R.P. Wynen (Consumer Computers), and Aff. of Harold Brookshire with Third Supp. Aff. of Ruth P. Wynen (Micro Business World).

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Had Apple not moved to prohibit mail order sales, it would have been confronted with precisely the problem described by the Rice Tire court:

> Failure to impose such sanctions would induce dealers to decrease the amount of services offered in order not to be undersold by free-riding dealers. Eventually, "these services might not be provided by retailers...despite the fact that each retailer's benefit would be greater if all provided the services than if none did."

483 F. Supp. at 757, quoting Sylvania. Apple's vertical restriction, like that imposed by Michelin, is reasonably necessary to insure the provision of point of sale support.

The Muenster Butane case provides a comparable situation. There, the manufacturer terminated a dealer who consistently undersold another of the manufacturer's dealers by free riding on that dealer's advertising and other support services. The court found that the defendant was dependent upon its dealer's promotional efforts in order to meet fierce competition; free riding disrupted those efforts. Accordingly, as in the Rice Tire case, the court found that the defendant's action was reasonable.

(iii) The restriction need only be "reasonably necessary"

The provision of adequate pre- and post-sale support and the elimination of "free riding" are recognized as legitimate business justifications for the imposition of vertical non-price restrictions. Apple's prohibition of the mail order sales of its products manifestly furthers those aims. The courts are unanimous in holding that the means-- here, the prohibition of mail order sales-- used by a defendant to accomplish legitimate purposes need not be the least restrictive, but only "reasonably necessary" to accomplish those purposes. See, e.g., Berkey Photo, Inc. v. Eastman Kodak, 603 F.2d 263 (2d Cir. 1979), cert. denied, 444 U.S. 1093 (1980); American Motor Inns, Inc. v. Holiday Inns, Inc., 521 F.2d 1230 (3d Cir. 1975); Rice Tire Corp. v. Michelin Tire Corp., 483 F. Supp. 750 (D. Md. 1980), aff'd, 638 F.2d 15 (4th Cir.1981), cert. denied, 50 U.S.L.W. 3248 (U.S. Oct. 6, 1981).

Apple's program more than satisfies the judicial criteria. Although Apple was aware of the debilitating effect of mail order sales on its competitive position as early as 1979, Markkula Dec. at ¶19, it did not actually move to prohibit mail order sales of its products until it had undertaken an exhaustive study of the situation. The study included a precise identification of the extent to which Apple products were being sold mail order, Carter Dec. at ¶¶28-30, the confirmation by an independent survey research firm of the costs associated with fully-supported sales and the consequent damage caused by free riding, Burwen Aff. at ¶¶14-15; Carter Dec. at ¶31, and consultation with an industry expert as to Apple's competitive prospects absent some action respecting mail order sales. Carter Dec. at ¶32; Rosen Dec. at ¶¶16-18.

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Apple's response to the problem of unsupported sales by mail order-- the contract modification-- was framed with precision and care. The prohibition addresses only the problem of unsupported mail order sales. Dealers, including these plaintiffs, remain free to charge whatever price they choose for the products they sell so long as the sales are fully supported by face-to-face instruction and supervised "hands-on" experience with the computer. As a result of Apple's prohibition, competition, both in the intrabrand and interbrand small computer market, will remain keen, and Apple will continue to be a viable competitor. All in all, then, Apple's mail order prohibition is precisely the type of reasonable, pro-competitive, consumer-oriented restriction that the courts have endorsed in Sylvania and its progeny.*

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* Only where a manufacturer has failed to meet any of the criteria for rule of reason treatment has a court held a vertical restriction to be illegal. The only rule of reason case since Sylvania to have reached that conclusion is Eiberger v. Sony Corp., 622 F.2d 1068 (2d Cir. 1980). There, the market was characterized by the absence of the vigorous interbrand competition found in the small computer market; the manufacturer proffered absolutely no legitimate business justification for its vertical restraint; nor was the vertical restraint reasonably necessary to accomplish any legitimate business aim. In fact, it operated only to inhibit competition and prevent price-cutting. These factors markedly distinguish Eiberger from the situation before this Court.

Furthermore, although the plaintiffs pointedly argue for the application of the Eiberger result in this case, they failed to bring to this Court's attention the fact that the reasoning and standards employed by the Eiberger court support Apple's position. The district court in Eiberger explicitly recognized the defendant's right to enforce a program of post-sale support (i.e., warranty and installation services). Id. at 1074. It found fault only with a fundamental change the defendant had made in the program after its initial implementation.

[Footnote continued on next page.]

3. Plaintiffs' assertion that the mail order prohibition is per se illegal finds no support in the case law.

Plaintiffs, recognizing the hopelessness of their position under the rule of reason, devote a substantial portion of their brief to the argument that Apple's mail order policy should be declared illegal "per se"-- a standard otherwise reserved for pernicious agreements among competitors and vertical price-fixing agreements. In urging the application of the per se rule, plaintiffs make two arguments. First, because full-support dealers have complained to Apple about mail order sales, and because full-support dealers will benefit to some extent from a prohibition of such sales, Apple's mail order policy should be considered a horizontal, rather than a vertical non-price restriction. Second, although Apple's

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[Footnote continued from previous page.]

This change in essence rendered the program a "sham." The Second Circuit affirmed the district court, noting that the defendant's program would have been perfectly legal if it had truly been intended to guarantee purchasers needed warranty service and had been structured to accomplish that aim. Id. at 1076-77.

According to the court, the program would have been entirely reasonable if the manufacturer had enforced a strict requirement that a selling dealer pay a non-selling dealer for warranty services actually performed by the latter. The fundamental flaw in Sony's program was that, after the change in the program's implementation, selling dealers were required to pay Sony a fee, regardless of whether the purchaser actually received the warranty service. Apple's program is specifically designed to avoid that deficiency. In order to operate within the parameters of Apple's mail order prohibition, Apple dealers need only properly support the sales they make by providing face-to-face instruction and supervised hands-on experience. In this manner, the consumer is actually guaranteed proper support, a result that was lacking in Sony's program.

prohibition of mail order sales does not regulate directly the prices dealers charge for Apple products, it may nevertheless affect those prices and, hence, according to the plaintiffs, should be considered vertical price-fixing, rather than a vertical non-price restraint.

These arguments are not unique. They have been advanced by almost every antitrust plaintiff since 1977 who sought to avoid the clear line of authority arising from Sylvania. These arguments have been uniformly rejected by the courts, and, accordingly, deserve only the most cursory consideration in this brief.

(a) Dealer complaints do not transform Apple's valid vertical restriction into a horizontal conspiracy.

Plaintiffs make much of the fact that full support dealers have complained to Apple about mail order sales.* Plaintiffs then assert:

> When a manufacturer responds to complaints from dealers concerning price competition or otherwise, and the response is to restrict territories and customers in which the offending dealers may operate, such conduct, although superficially a vertical restraint of competition, is, in reality, a horizontal restraint of competition and is illegal per se . . . .

Points and Authorities at 45-46.

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* Plaintiffs also suggest that complaints concerning price cutting and mail order dealers were aired in Apple's Dealer Council. Points and Authorities at 24. This suggestion is not supported at any point in plaintiffs' papers, nor could it be. It is simply untrue. See Rogers Dec. at ¶¶9-15.

This assertion is absolutely incorrect and has been categorically rejected by the courts. See, e.g., H. L. Moore Drug Exchange v. Eli Lily & Co., 1981-2 Trade Cas. ¶64,335 (2d Cir. 1981); Edward J. Sweeney & Sons, Inc. v. Texaco Inc., 637 F.2d 205 (3d Cir. 1980); cert. denied, ___ U.S. ___, 101 S.Ct.1927 (1981); Blankenship v. Herzfeld, 1981-2 Trade Cas. ¶64,321 (10th Cir. 1981); Rice Tire Co. v. Michelin Tire Corp., 638 F.2d 15 (4th Cir. 1981), cert. denied, 50 U.S.L.W. 3248 (U.S. Oct. 6, 1981); A. H. Cox & Co. v. Star Machinery Co., 653 F.2d 1302 (9th Cir. 1981); Davis-Watkins Co. v. Service Merchandise Co., 500 F. Supp. 1244 (M.D. Tenn. 1980).*

The authorities are simply too numerous to discuss each in detail; a few examples should suffice in any event. The defendant in the Rice Tire case imposed an anti-wholesaling policy and territorial restrictions upon its distributors and, as a consequence of this policy, terminated one of the distributors because of its large-scale wholesaling. The manufacturer conceded that complaints from competing dealers contributed to its decision to terminate the plaintiff, but the court nevertheless viewed the case as a vertical restriction and applied the rule of reason.

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* Additional authorities abound. Furthermore, numerous other decisions have reached the same conclusion implicitly. For example, this Circuit in Cowley v. Braden Industries, Inc., 613 F.2d 751 (9th Cir. 1980) cert. denied, 466 U.S. 965 (1980), applied the rule of reason analysis to a manufacturer's restrictions, even though a competing dealer had vociferously complained. Similarly, in Muenster Butane, Inc. v. Stewart Co., 651 F.2d 292 (5th Cir. 1981), the court stated that it was presented with a classical vertical restraint case,even though the manufacturer had terminated the dealer partly as a result of competing dealers' complaints that the plaintiff had violated the manufacturer's location restrictions.

Edward J. Sweeney & Sons, Inc. v. Texaco, Inc., 637 F.2d 105 (3d Cir. 1980), cert. denied, ____U.S.____ 101 S.Ct.1927 (1981) is a similar case. There, the plaintiff-dealer charged that the defendant had lowered its allowances and, hence, raised the plaintiff's costs because of complaints from competing dealers concerning plaintiff's low prices. In short, plaintiff's theory was that the competing dealers' complaints and the defendant's reaction to those complaints constituted a conspiracy in restraint of trade. The court pointedly rejected this contention, noting that even if plaintiff could demonstrate that defendant acted in response to these complaints, such evidence would not show a horizontal restraint of trade in the form of a conspiracy between the manufacturer and its dealers.

> To permit the inference of concerted action on the basis of receiving complaints alone and, thus, to expose the defendant to treble damage liability, would both inhibit management's exercise of its independent business judgment and emasculate the terms of the statute. . . . [M]any cut-off dealers in this situation will be tempted to harass their former suppliers with treble damage suits.

Id. at 111 n. 2.

The Ninth Circuit reached the identical result in A. H. Cox & Co. v. Star Machinery Co., 653 F.2d 1302 (9th Cir. 1981). There, one distributor was terminated at the request of another distributor, who eventually assumed the product line previously carried by the terminated distributor. In its lawsuit against the former supplier, the terminated distributor argued that the "thrust of the transaction [was] horizontal" since the termination was requested by another distributor. The court disagreed, reasoning that "the economic impact resulting from the change in distributors is not altered merely because the dealer initiated contact or actively sought the change, provided the manufacturer ultimately makes the decision based on its independent business judgment." Id. at 1307. The court, therefore, held that the "attempt to cast the arrangement in horizontal terms must fail." Id.

Plaintiffs rely principally on two cases to support their claim that the receipt of dealer complaints transforms the manufacturer's non-price restriction into a horizontal conspiracy: the district court opinion in Eiberger v. Sony Corp., 459 F. Supp. 1276 (S.D.N.Y. 1978), aff'd in part, 622 F.2d 1068 (2d Cir. 1980), and Cernuto, Inc v. United Cabinet Corp., 595 F.2d 164 (3d Cir. 1979). Neither of these decisions provides support for plaintiffs' position. By the express terms of its opinion, the district court in Eiberger rested its conclusion that Sony's warranty fee program violated the antitrust laws on two theories: (1) failure to satisfy the rule of reason, and (2) the fact that competing dealers' complaints made the restriction horizontal in nature rather than vertical. As these plaintiffs themselves admit, the Second Circuit affirmed the lower court only on the first of these theories, a factual situation entirely distinguishable from the one before this Court. See, footnote, pp.49-50 supra.

Furthermore, these plaintiffs have failed to inform this court that subsequently the Second Circuit expressly rejected the second of the two theories-- the theory of horizontal conspiracy on which these plaintiffs rely. In the H. L. Moore Drug case, see supra, p. 52, decided this year, the Second Circuit rejected the argument that "a manufacturer's mere acceptance of complaints from its wholesalers or agents who compete with the plaintiff, or its consultation with such other competing wholesalers" supports a finding of conspiracy. 1981-2 Trade Cas. at 74,558. In spite of the dealer complaints, the Second Circuit viewed the manufacturer's actions as strictly vertical in nature and applied rule of reason analysis.

The decision in Cernuto, Inc. v. United Cabinets Corp., 595 F.2d 164 (3rd Cir. 1979), stands for the proposition that if a manufacturer's decision to terminate a retailer is motivated solely by considerations of the dealer's price, and this motivation arises from pressure from competing dealers, a conspiracy exists between the manufacturer and the competing dealers. Id. at 170. Since there is simply no way the record in this case can be read to conclude that Apple's action is motivated solely by price, Cernuto is clearly distinguishable.

Furthermore, the Cernuto holding has been distinguished and explained into virtual oblivion by subsequent cases, including a case in the Third Circuit. In Edward J. Sweeney & Sons, Inc. v. Texaco, Inc., 637 F.2d 105 (3d Cir. 1980), cert. denied, ____ U.S. ____, 101, S.Ct 1927 (1981), see page 53 supra, the Third Circuit explicitly rejected the argument that a manufacturer's

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actions regarding a dealer's prices, even when motivated by complaints from competing dealers, should be considered conspiratorial and judged per se illegal. Id. at 110. Similarly, the Ninth Circuit in Ron Tonkin Gran Turismo, Inc. v. Fiat Distributors, Inc., 637 F.2d 1376 (9th Cir. 1981), cert. denied, 50 U.S.L.W. 3246 (U.S. Oct. 6, 1981), noted the existence of the Cernuto decision, but declined to apply the Cernuto per se rule, where the manufacturer refused to do business with the retailer because of complaints from other retailers. The court held that the per se rule should not apply to a manufacturer's action in this circuit unless that action "had or was likely to have a pernicious effect on competition and lacked any redeeming virtue." Id. at 1388.

Whatever the precedential value of the Cernuto rule, it does not apply unless a complete termination is involved. Contractor Utility Sales Co. v. Certain-Teed Products Corp., 638 F.2d 1061 (7th Cir. 1981); JBL Enterprises, Inc. v. Jhirmack Enterprises, Inc., 519 F.Supp 1084 (N.D. Cal. 1981). Since the dealerships of the plaintiffs in this case have not "been taken away" as a result of Apple's mail order policy, the Cernuto rule is inapposite. JBL Enterprises, Inc. at 1092-93.

In sum, courts have roundly rejected the notion that dealer complaints render a manufacturer's restriction horizontal in nature, even if the restriction was motivated by those complaints. The record in this case, of course, does not in any sense support an allegation that Apple's mail order prohibition was motivated by dealer complaints. The record amply demonstrates that, far from a spasmodic reaction to dealer pressure, Apple's mail order prohibition was implemented only after the most careful market research, consideration, and consultation, all of which indicated that the prohibition was vital to Apple's interest.

The cases clearly indicate that where, as here, a manufacturer has imposed a restriction primarily for his own benefit, for example to increase the competitiveness of the manufacturer's product, then it is a vertical restriction requiring rule of reason analysis. *See*, *e.g.*, *Rice Tire Co. v. Michelin Tire Corp.*, 638 F.2d 15 (4th Cir. 1981), *cert. denied*, 50 U.S.L.W. 3248 (U.S. Oct. 6, 1981); *A. H. Cox & Co. v. Star Machinery Co.*, 653 F.2d 1302 (9th Cir. 1981); *H & B Equipment Co. v. International Harvester Co.*, 577 F.2d 239 (5th Cir. 1978); *Newberry v. The Washington Post Co.*, 438 F. Supp. 470 (D.D.C. 1977). Plaintiffs' argument, then, is simply a dead letter.*

(b) Plaintiffs' allegation of vertical price-fixing finds no support in the case law.

The other argument advanced by plaintiffs for application of the per se rule is equally without merit. In a rather contorted argument plaintiffs contend that Apple's mail order prohibition might result in higher consumer prices, and should, therefore, be judged illegal per se as vertical price-fixing:

> The inexorable effect of Apple's modification

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* Cited in plaintiffs' brief is *United States v. General Motors Corp.*, 384 U.S. 127 (1966), a horizontal conspiracy case. Whatever the continuing vitality of that case after *Sylvania*, we note in passing that *General Motors* dealt with a factual situation vastly different from the situation before this Court. There, the manufacturer joined a pre-existing dealer conspiracy and actually enlisted the aid of the dealers in monitoring compliance with the conspiracy. Such facts are not even alleged here.

> of its dealer agreement will be a rise in prices to the ultimate consumer. This is forbidden and constitutes a per se violation of the antitrust laws....

Points and Authorities at 29.

Again, plaintiffs' argument finds absolutely no support in the case law. On the contrary, courts have uniformly rejected the argument that a manufacturer's non-price restrictions actually stabilize and maintain prices, and, therefore, are a form of resale price maintenance which should be declared illegal per se. Courts have responded to this argument by requiring plaintiffs to show direct evidence of an announced pricing policy plus coercion to enforce that policy before invoking the per se rules of illegality. See, e.g., Aladdin Oil Co. v. Texaco, Inc., 603 F.2d 1057 (5th Cir. 1979); Eastern Scientific Co. v. Wild Heerbrugg Instruments, Inc., 572 F.2d 883 (1st Cir. 1978), cert. denied, 439 U.S. 833 (1979); In Re Nissan Antitrust Litigation, 577 F.2d 910 (5th Cir. 1978), cert. denied, 439 U.S. 1072 (1979); JBL Enterprises, Inc. v. Jhirmack Enterprises, Inc., 519 F.Supp 1084 (N.D. Cal. 1981).

Here, the record which plaintiffs themselves cite amply demonstrates that Apple has not engaged in enforcement of an announced pricing policy. For example, plaintiffs acknowledge that Apple has told all of its dealers that it cannot dictate retail prices. The plaintiffs even cite an Apple publication which conveys this message in no uncertain terms.

> [O]nce a dealer purchases Apple Products from us, we are constrained by government

> regulations from specifying... what the price is to be.

Points and Authorities at 21.

Similarly, the Apple Dealer Agreement specifies that the dealer is to have sole discretion concerning his retail prices. See Carter Dec. at ¶21.

Even assuming plaintiffs are correct in terms of the consequences of the mail order prohibition (a result which is by no means clear), they are left with what is at very most a vertical non-price restriction that may have some pricing consequences. Even if Apple's mail order prohibition tends "to stabilize prices, [that] does not move the restriction into the category of naked restraints against which the per se rules apply." *Davis-Watkins Co. v. Service Merchandise Co.*, 500 F. Supp. 1244, 1250 (M.D. Tenn. 1980). In the final analysis, then, plaintiffs have failed to make even a colorable argument that Apple's conduct should be judged illegal per se.* As the *Davis-Watkins* court stated:

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* Equally specious is plaintiffs' contention that the mail order restriction is illegal per se because Apple engages in "dual distribution." Point and Authorities at 62-67. the fact that plaintiffs cite no case law support for this proposition is not surprising, since it is settled law that restrictions imposed by a manufacturer in the context of dual distribution are subject to rule of reason and not per se analysis. *See*, *e.g.* *Copy Data Systems, Inc. v. Toshiba America, Inc.*, No. 80-9048 (2d Cir. Nov. 2, 1981); *Abadir & Co. v. First Mississippi Corp.*, 651 F.2d 422 (5th Cir. 1981); *Red Diamond Supply, Inc. v. Liquid Carbonic Corp.*, 637 F.2d 1001 (5th Cir. 1981), *cert. denied*, 50 U.S.L.W. 3246 (U.S. Oct. 6, 1981); *Krehl v. Baskin-Robbins Ice Cream, Co.*, 1979-2 Trade Cas. ¶62,806 (C.D. Cal. 1979).

> When a party does not allege a traditional anti-competitive restraint with which the courts have had considerable experience in evaluating its harmful effects on competition, the Court should not apply a per se rule. See Broadcast Music, Inc. v. CBS, 441 U.S. 1, 19 n. 33; United States v. Topco Associates, Inc. 405 U.S. at 607-08.

_Id_. at 1250.

Plaintiffs have failed to make even a minimal showing of success on the merits. Their arguments that Apple's mail order prohibition should be held illegal per se finds absolutely no support whatever in the case law. The company's mail order policy should, therefore, be analyzed under the rule of reason. Since the small computer market is highly competitive, and since Apple has several legitimate business aims which the mail order prohibition advances, there is no question but that the company's actions have been entirely legal.

CONCLUSION

On December 4, 1981, this Court ruled that plaintiffs had failed to demonstrate the requisites for a temporary restraining order-- irreparable injury and the probability of prevailing on the merits. The plaintiffs must meet these same criteria for preliminary injunctive relief, yet their proof has not improved in any way since the Court's ruling. In short, plaintiffs have failed in every respect to carry their burden of satisfying the three criteria for preliminary injunctive relief.

At the outset, plaintiffs have failed to demonstrate irreparable injury. Alternative products are manifestly available to plaintiffs and, in any event, whatever injury they suffer is fully compensable by an award of monetary damages. Nor will plaintiffs suffer any injury as a result of their alleged outstanding commitments. Under the contract modifications which they have signed, they will be required only to provide adequate support, including face-to-face instruction and supervised "hands-on" computer experience, for their sales of Apple products.

Plaintiffs' alleged injury from a denial of injunctive relief pales in comparison to the harm Apple will suffer if a preliminary injunction is issued by this Court. Apple will be forced to withdraw its mail order prohibition on a national basis. Under such a scenario, independent dealers would have no motivation to continue to support the sale of Apple products, and Apple would lose market position to larger vertically-integrated competitors which are readily able to guarantee that the sale of their products will be properly supported. In addition, independent dealers would lose enthusiasm for promoting Apple products and instead devote their energies to the products of Apple's competitors. The result would be disastrous for Apple; even if the company ultimately prevailed on the merits, there would be no way to recover its lost market position.

This result is all the more indefensible because plaintiffs have absolutely no chance of prevailing on the merits. Apple's vertical non-price restriction must be judged under the rule of reason. Because of the fierce competition in the small computer market and the absence of market power by Apple, there is no question but that the mail order prohibition is entirely lawful. In addition, the prohibition is reasonably necessary to further aims which have been uniformly endorsed by the case law -- the provision of pre- and post-sale consumer support and the elimination of free riders. Plaintiffs' assertion that the mail order prohibition is per se illegal finds no support whatever in the case law.

Plaintiffs have failed to meet even one of the three criteria for preliminary injunctive relief. Accordingly, this Court should deny plaintiffs' request. Furthermore, in light of the publicity that the filing of plaintiffs' complaint has generated and the injury that this publicity has caused Apple, the Court should enter the protective order requested by defendant.

Respectfully submitted,

FENWICK, STONE, DAVIS & WEST

By: William A. Fenwick
William A. Fenwick

APPENDIX

Agmc

ASSOCIATION OF GENERAL MERCHANDISE CHAINS, INC.
1625 EYE STREET, N.W., WASHINGTON, D.C. 20006 (202) 785-2060

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Mattingly Stores/Matco
*JAMES A. TONGES,
McCrory Stores
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The Tresslar Co., Inc.
*EXECUTIVE COMMITTEE

September 16, 1982

Sen. Lowell P. Weicker, Jr.
Chairman
Committee on Small Business
Room 424
Russell Senate Office Building
Washington, D.C. 20510

Dear Senator Weicker:

On behalf of the Association of General Merchandise Chains, Inc., I am submitting a statement on resale price maintenance. I ask that it be included in the record of the September 9th hearings jointly held by your Committee and the Appropriations Subcommittee on State, Justice, and Commerce, the Judiciary, and Related Agencies.

AGMC represents retail companies operating discount, variety, dollar and family center stores. Our price-competitive industry would be severely harmed by a return to resale price maintenance schemes like those Congress struck down in repealing antitrust immunity for state "fair trade" laws.

We hope that your Committee will continue the fine start it has made in seeing that the Department of Justice enforces the current law, and in encuring that the Antitrust Division is not permitted to follow its announced intention of participating in private litigation to overturn the well-settled legal principle that resale price maintenance is per se illegal.

Thank you for your consideration. Please feel free to call on us if we can be of assistance to you in any way.

Sincerely,

Edward T. B

Edward T. Borda
President

. . . the national organization and unified voice for chain store retailers

Agmc ASSOCIATION OF GENERAL MERCHANDISE CHAINS, INC.
1625 EYE STREET, N.W., WASHINGTON, D.C. 20006 (202) 785-2060

STATEMENT OF THE
ASSOCIATION OF GENERAL MERCHANDISE CHAINS, INC.
TO
COMMITTEE ON SMALL BUSINESS
AND THE COMMITTEE ON APPROPRIATIONS
SUBCOMMITTEE ON COMMERCE, JUSTICE, AND STATE, THE JUDICIARY
AND RELATED AGENCIES
U.S. SENATE

Submitted by:

Edward T. Borda
President, AGMC

September 9, 1982

APPENDIX

Agmc
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1625 EYE STREET, N.W., WASHINGTON D.C. 20006 (202) 785-2060

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Sincerely,

Edward T. B

Edward T. Borda
President

. . . the national organization and unified voice for chain store retailers

The Association of General Merchandise Chains, Inc. (AGMC) represents the nation's discount and variety general merchandise retail industry and appreciates this opportunity to share with these Committees the profound concerns that general merchandise retailers have because of the refusal of the Antitrust Division to enforce the existing law against vertical price-fixing.

AGMC represents 125 retail companies operating discount, variety, dollar and family center stores. While AGMC members range in size and include large national or regional retail chains, nearly three-quarters of our members meet the definition of "small business" currently proposed for our industry by the Small Business Administration.

The issue of resale price maintenance, that is coercion of distributors or retailers to sell merchandise only at a fixed price, unites the members of our industry, whether they operate a single store or a major chain. The Antitrust Division's announced plans to ignore, and to even try to overturn the legal principle which outlaws resale price maintenance, are seen by our price-competitive members as a direct threat to their continued existence. We strongly urge these Committees to take every step in its power to see to it that the legal safeguards against resale price maintenance are upheld, not subverted, by the nation's top antitrust officials.

INTRODUCTION

The legal rule prohibiting resale price maintenance is well-established. Since 1911, a long line of Supreme Court cases has held that coercive efforts by manufacturers or others to dictate the prices at which products could be sold by independent distributors or retailers is so inherently anti-competitive as to be an automatic, or per se, violation of Federal antitrust law.

In the 1930's, Congress created an exception to this rule for so-called state "fair trade" laws, which authorized restrictions on retail price competition. Those state laws were widely and persuasively criticized by consumers, many retailers, and Federal antitrust officials in both Democratic and Republican Administrations. Extensive economic evidence presented in Congressional hearings showed that state-sanctioned resale price maintenance drives up consumer prices, narrows consumer choices and harms the efficiency of the nation's distribution system. It was specifically demonstrated that, far from helping small businesses, resale price-fixing is particularly harmful to small enterprises.

After years of consideration and development of a very full evidentiary record, Congress responded by enacting the Consumer Goods Pricing Act, which effectively abolished state "fair trade" laws, finding them to be anti-competitive and inflationary.

Let me emphasize that the economic and competitive case against resale price maintenance has been convincingly established. As former Assistant Attorney General Thomas E. Kauper stated in 1975 testimony supporting repeal of "fair trade" laws:

> All but a very few of the numerous economists and marketing experts who have studied the problem believe that the benefits of resale price maintenance are not sufficiently large to offset such deficiencies as higher prices, reduced consumer choice, and the suppression of marketing innovation.

Professor Phillip C. Neal, Dean of the Chicago Law School, while serving on a 1968 Antitrust Task Force, reported:

> The case against resale price maintenance has been made so often and so persuasively that we think no further elaboration is necessary. We recommend repeal of the antitrust exemption for resale price maintenance.

Repeal of "fair trade" law was also supported in testimony by Assistant Attorney General Kauper. He termed the privileged status of resale-price fixing under "fair trade" laws:

> ...an unjustified exeception in the policy of the antitrust laws, which call for the determination of price by the unfettered interplay of supply and demand in the marketplace. Repeal of this anachronism will significantly aid the effort against artifically high prices.

He also noted that resale price maintenance facilitates horizontal price-fixing.

Further, *per se* illegality of resale price maintenance has been repeatedly affirmed by the Supreme Court since 1911, and indeed, that Court noted in a 1977 decision that Congress had endorsed the *per se* rule by repealing the antitrust immunity for state "fair trade" laws. And, as mentioned earlier, the prohibition on price-fixing from above has been a cardinal principle of antitrust law under every Administration of the past several decades.

ANTITRUST OFFICIALS ATTACK ESTABLISHED BAN ON RESALE PRICE-FIXING

In recent days, however, several top Federal antitrust officials have begun a campaign to overturn the *per se* rule of illegality for resale price maintenance. FTC Chairman James Miller has argued in favor of abandoning the *per se* rule and the Agency's Bureaus of Competition and Economics are at work on various critiques of the *per se* rule. While agency staff is developing some theoretical alternatives to the per se rule, the Commission itself remains on the record in support of the per se rule. In recent months at the FTC, there has been a fair amount of enforcement activity related to resale price maintenance, primarily through decisions and consent orders in cases dating back some years.

However, at the Antitrust Division of the Department of Justice, Assistant Attorney General William Baxter and staff have on numerous occasions announced their disagreement with the per se rule and begun a two-fold assault on this important safeguard for retail price competition.

First, the Antitrust Division's chief has announced that he will not enforce the legal prohibition against resale price maintenance except when, according to his own economic views, it would be desirable to do so. Second, the Antitrust Division has announced that it plans systematic amicus participation through its "Private Action Program" in selected private antitrust lawsuits for the purpose of overturning the current per se illegality of resale price maintenance. This effort runs directly counter to the intent evident in Congress' repeal of "fair trade" laws, and the strong approval there of the per se doctrine. If allowed to proceed, the Private Action Program will permit the Antitrust Division to devote its resources to overturning, not upholding, the will of Congress.

AGMC strongly believes that any departure from present law as radical as allowing vertical price-fixing must come only after action by Congress, with all parties given an opportunity to be heard and a full consideration of the impact that such a fundamental change would have on consumers, the economy and the nation's system of distribution.

Attached to AGMC's testimony is one illustration of the Antitrust Division's attack on the clearly-settled law prohibiting vertical price-fixing. A front-page Washington Post article published on August 13, 1982 noted the concerns of retailers and others over the Antitrust Division's refusal to act against resale price maintenance activities. According to this article:

> Although this price setting violates federal law, according to Assistant Attorney General William F. Baxter, it has his blessing in most cases.
>
> Baxter, chief of the Justice Department's Antitrust Division, said in an interview that he agrees with critics who charge that these pricing agreements are illegal and may result in higher costs to consumers. But since he has other reasons for believing that the laws against this form of price setting don't make good economic sense, Baxter said he will only enforce them in special cases.

The article goes on to quote Mr. Baxter:

> "The disagreement is not about the present state of the law so much as whether that law really makes sense," Baxter said. "The Supreme Court has said on a variety of occasions that vertical price-fixing is *per se* illegal... It is the position of the Antitrust Division that (this practice) should not be illegal *per se* in view of certain competitive principles."

In addition to refusing to enforce the well-established law except where it is in line with his personal economic views, Mr. Baxter is also heading up another line of attack on the rule making resale price maintenance *per se* illegal.

Assistant Attorney General Baxter has identified this planned program of systematic *amicus* participation in private antitrust lawsuits, at both the trial and appellate levels, as a major policy initiative. As numerous statements from the Antitrust

Division have made clear, a key objective of the Private Action Program will be an attack on the per se illegality of resale price maintenance, and an attempt to substitute in its place an undefined balancing test which would in all likelihood require injured retailers and distributors not only to prove the existence of a resale price maintenance scheme, but to also shoulder the tremendous burden of undertaking a broadscale economic analysis to identify the precise competitive harm in the affected industry. Such a drastic policy change would clearly limit, if not destroy, the ability of small businesses to challenge illegal restraints on their competitive pricing freedom.

AGMC believes that attempts to bring the nation's antitrust enforcers into private lawsuits to attack law well-settled by Congress and the Supreme Court misuses the Antitrust Division's valuable resources and exceeds its proper authority.

Rather than a "backdoor" effort to encourage the type of curbs on price competition which Congress struck down by passing the Consumer Goods Pricing Act, the proper course would be a request by the Antitrust Division to Congress for legislative change.

SMALL BUSINESS IS HARMED, NOT HELPED, BY RESALE PRICE-FIXING

The evidence before Congress when it outlawed "fair trade" laws showed that resale price-fixing does not help, and may actually harm small enterprises. One persuasive study compared the experience of retailers in "fair trade" and non-"fair trade" areas over a 25-year period (1933 - 1958). In that study by Dr. Stewart M. Lee, it was found that:

> ...retailers did not fare better or worse in states without fair-trade than in those that had fair-trade legislation. ...it would seem that, if anything, the non-fair trade states showed a slight advantage over the others...

Dr. Lee's study, published in the Journal of Retailing (Spring 1965), also found that:

> The best data available do not support the contention that the enactment of fair-trade laws lessens the number of retail failures or bankruptcies or increases the number of retail stores. Whatever effect they have apparently has been slight and in an opposite direction to the one claimed by proponents of fair-trade.

Another study in 1962, undertaken by the Department of Justice, studied retail failures and bankruptcy rates in states without "fair trade" laws, and found them to be significantly lower than in states with "fair trade" laws. In states with the most extreme "fair trade" laws, i.e. those which restricted price competition even by retailers who had not signed a pricing agreement with manufacturers, the failure rate averaged 71 out of every 10,000 firms. In "fair trade" states without non-signer provisions, the rate was 51 firm failures per 10,000 firms. For states without curbs on resale prices, the failure rate was only 29 per 10,000 firms.

The Library of Congress later updated those estimates based on 1972 Dun and Bradstreet data, and found that states without "fair trade" laws that year averaged 23.3 failures per 10,000 firms, while states with "fair trade" laws lacking a non-signer provision averaged 32.2 failures per 10,000 firms. In "fair trade" states with laws including non-signers, the rate was 35.9 failures per 10,000 firms. According to the Library of Congress analysis:

> ...in other words, fair trade states with fully effective (fair trade) laws have a fifty-five percent higher rate of firm failures than free trade states.

It is also apparent that resale price maintence arrangements authorized under "fair trade" laws did not promote the growth of small retail businesses or of retail firms carrying "fair traded" items. According to Department of Commerce data analyzed in 1975 by the Library of Congress, between 1956 and 1972, the rate of growth of small retail stores in free trade states (including states which repealed "fair trade" laws during this period) was 32% higher than in "fair trade" states.

Resale price maintenance, by foreclosing the ability of small retailers to engage in price competition, in fact acts as an additional obstacle to entry by new firms and a competitive disadvantage to established ones.

RESALE PRICE-FIXING RAISES CONSUMER PRICES

There is another point that should be made about the impact of resale price maintenance on small business. Restricting price competition naturally leads to higher prices to consumers — and small businesses are of course consumers just like you or me.

Some idea of just how serious a threat this is can be had by looking at the wide variety of government studies that estimated the costs to the nation's consumers from price maintenance under the old state "fair trade" laws. These studies consistently found that allowing resale price maintenance adds billions of dollars each year to consumer prices. In 1956, for instance, the Antitrust Division surveyed consumer prices on numerous products and found that, in states with resale price maintenance agreements sanctioned under "fair trade" laws, consumer prices for "fair traded" goods ranged from 19% to 27% higher than in states without "fair trade" laws.

Another Antitrust Division survey in 1970 examined the prices of 78 "fair traded" items during the week of June 26, 1970 in 57 discount and department stores in 10 cities in four states without "fair trade" laws. It found prices ranging anywhere from 0.2% to 27.4% below the price enforced by manufacturers in "fair trade" states.

In 1975 hearings before the State Attorney General of California, economist Lawrence Shepard of the University of California estimated that direct and secondary costs of "fair trade" laws meant $6.5 billion in added costs to consumers each year.

The Library of Congress Economics Division also developed a range of estimates for the direct costs alone created by "fair trade" laws. Using various projections of the percentage of retail sales at "fair trade" prices and the percentage by which that price would exceed normal competitive levels, the Library of Congress estimated that, in 1973, the direct costs to consumers of lessened retail price competition due to "fair trade" ranged between $874 million (lowest projection) and $8.851 billion (highest projection).

The study's mid-range projections, assuming 4% of retail sales affected by "fair trade" restrictions, ranged from $1.748 billion (if "fair trade" restrictions raised retail prices by 10%), $3.322 billion (with a 19% price increase, the average for all items surveyed in an Antitrust Division study) and $4.721 billion (with a 27% price increase, the level reported on items not sold at "fair trade" prices).

Other evidence in the legislative history leading up to Congressional repeal of "fair trade" laws demonstrates the price-boosting effect that resale price maintenance produces. A 1974 survey by the Marketing Science Institute examining the impact of repeal of fair trade laws in Rhode Island found price decreases in four of nine product line surveyed. The reductions averaged between 20% and 40%; all but one of the nine manufacturers reported no sales decline after repeal of the state "fair trade" law. British and Canadian reports likewise found beneficial effects from repeal of "fair trade" laws there.

The 1975 "fair trade" hearings compared retail prices for identical merchandise sold by catalog showrooms in "fair trade" and non-"fair trade" jurisdictions. On some items cited, these prices varied by as much as 64%. A number of retail witnesses gave examples of the concrete savings, generally ranging from 20% to 40%, available to all consumers following the repeal of "fair trade" laws. A re-institution of resale price maintenance will erase these savings and substantially increase retail costs to consumers.

There is ample evidence that resale price maintenance schemes drive up the cost of goods to consumers, but higher consumer prices are not the only drawback of resale price maintenance. The practice also narrows consumer choices. Our economic system is based on the belief that the free choices of consumers in a competitive marketplace will determine the most efficient and accurate allocation of goods and services. Retail price-fixing robs consumers of their freedom to comparison shop for the combination of price, convenience and service that best matches their needs.

While some manufactures will attempt to justify a higher fixed price as needed to pay for a variety of product-related services and promotions, this really misses the central point. It should be consumers themselves -- not the manufacturers and not the government — who decide what's important to them. Fixing retail prices in essence amounts to a hidden tax on all consumers to pay the costs of manufacturer-desired services and promotion, whether or not consumers desire or require them. This is totally out of keeping with a genuine commitment to free marketplace competition.

If current safeguards against resale price maintenance are dropped, goods whose prices at retail remain under the manufacturer's control will become less available, since retail outlets whose marketing strategy centers on price competition are less likely to carry those price-controlled goods. So a ban on price competition in the marketplace will not only foreclose a consumer's ability to shop for a product on the basis of price but will also lead consumers to experience greater inconvenience in finding the product they desire even at the manufacturer-set price.

RESALE PRICE-FIXING WOULD HARM THE NATION'S ECONOMIC RECOVERY

Retail price competition plays a significant role in fighting inflation. In the intensely competitive retail marketplace, market forces acting freely promote efficiency in the nation's distribution system and offer consumers a full array of goods at competitive levels of price and service. I will note in passing that even though the retailing industry is generally subject to the same types of increases in operating costs as most other businesses (such as labor, taxes, interest, energy, rents, insurance and materials), vigorous price competition and the knowledge that their customers are free to seek out the best values have led retailers to hold down merchandise prices. It is no coincidence that, over the past 15 years, prices increases in the highly competitive general merchandise retail industry have been only about half as much as increases in the overall cost-of-living, as measured by the Consumer Price Index.

Since retail price-fixing is designed to eliminate competition among retailers, it will naturally result in a higher cost of living. At a time when controlling inflation and interest rates are identified as top economic priorities, reduced price competition would work against those key elements in the national recovery program.

Given these serious economic implications, the Department of Justice should carefully measure and thoroughly analyze the impacts that renewed resale price maintenance would have on consumers, distributors and inflation-fighting efforts. Such a review should not be limited to theoretical considerations, but also ought to include a comprehensive analysis of all major economic issues involved, including such direct impacts as sharply higher consumer price levels, lower sales volumes, increased general inflation rates and consequent impacts on small business, the Federal budget and the national economy.

The inflationary effect of resale price-fixing, incidentally, has been acknowledged by the Federal antitrust officials who are seeking to weaken the current safeguards for retail price competition. A recent Washington Post article outlining the Antitrust Division's controversial views on resale price maintenance noted that:

Baxter concedes that prices may rise in the short run if manufacturers are allowed to specify minimum retail prices.

While AGMC has expressed its concern directly to the Antitrust Division over the heavy price that the nation's consumers, small businesses and retail system will have to pay if Mr. Baxter succeeds in bringing back resale price maintenance, to date, we have not heard from them even a ballpark estimate of the costs of making this major policy change.

Advocates of resale price maintenance overlook one basic fact: resale price maintenance does not guarantee that manufacturer-desired promotion or services will be provided in all cases; it just acts to fix the retail price.

Moreover, manufacturers have a wide variety of devices, such as promotional allowances, service contracts and the like, for ensuring that retailers selling their products take part in desired promotional or service activities. Unlike price-fixing, these incentives are targeted to achieve a specific objective and are not inherently anti-competitive.

CONCLUSION

Our industry regards as vital the continued ability to determine the retail price levels for the merchandise it has bought and paid for.

Price is a central concern for any business enterprise, but in no other quite so clearly as in the retail industry. Every analysis points to retailing as the most highly competitive segment of the economy. A merchant's ability to determine what merchandise to offer and what prices to ask are absolutely essential to healthy retail competition. Although retail firms compete with each other in many ways: merchandise selection, consequences. Antitrust officials should not seek to overturn the per se rule, but rather should enforce it in line with Congressional intent and clear judicial precedent.

The Assistant Attorney General has the sworn duty to uphold and enforce settled antitrust law, regardless of his personal views. If he disagrees with that law, his proper course is to come to Congress with a legislative proposal, not to refuse to enforce that law or to participate in private lawsuits in order to overturn law affirmed by both Congress and the Supreme Court.

Thank you once again for this opportunity for AGMC to share with these Committees our profound concerns over the Antitrust Division's refusal to enforce, and announced intention to undermine, the well-settled law prohibiting resale price-fixing. We hope that these Committees will continue to work to preserve this important competitive safeguard.

LOWELL WEICKER, JR., CONN., CHAIRMAN
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United States Senate
COMMITTEE ON SMALL BUSINESS
WASHINGTON, D.C. 20510

September 29, 1982

Francis Ravel
Olympic Sales Company, Inc.
216 S. Oxford Avenue
P.O. Box 74545
Los Angeles, CA 90004

Dear Francis:

Many thanks for your statement detailing your meeting of March 4 with Mr. William Baxter. I have instructed the staff to have your statement incorporated into the hearing record when it is published.

I truly appreciate the support you have given to my campaign efforts. I look forward to seeing you at the next Advisory Council meeting.

Hope all is well with your family.

With best wishes, I am

Sincerely,

LOWELL WEICKER, Jr.
Chairman

OLYMPIC SALES COMPANY, INC. 216 S. Oxford Avenue. Los Angeles, California 90004 • P.O. Box 74545
Telex 67 34 77 • Cable Address "OLYRAV" LSA (213) 739-1100

OLYMPIC

August 28,1982

The Honorable Lowell Weicker
Chairman
Committee on Small Business
Washington D.C 20510

Dear Senator,

I wish to thank you very much for your August 20,1982 letter.

I am enclosing for your inspection a Statment signed by me which can be used at your discretion.

I understand there is going to be a hearing on September 9th with Senator Warren Rudman and Senator Slade Gorton regarding some questions about Mr. William Baxter's behavior.

I cross my fingers and sincerely hope that everything will go well for you in November, as I sincerely believe that Washington needs more people like yourself who are dedicated, sincere, hard workers and determined.

I shall be most happy to help in your campaign as I have a systematic way of performing well.

Looking forward to see you soon, I remain

Kindly convey to your family my best wishes.

Sincerely yours

Francis Ravel

FR/ln

TO WHOM IT MAY CONCERN

I, Francis Ravel, a Los Angeles, California resident, hereby state the following:

On March 4, 1982 at 2:00 P.M., I met with Mr. William Baxter, who is the Head of the Anti-Trust Division of the Department of Justice in Washington, D.C. Present were: Mr. William Baxter, Mrs. Melanie Stewart Cutler, Special Assistant to the Assistant Attorney General, Anti-Trust Division, Mr. Thomas Mauro, an attorney with offices in Washington, D.C., who was present on my behalf, and myself.

The meeting lasted close to 90 minutes and the subject was the new climate regarding Anti-Trust matters. Here is some of the dialog to the best of my recollection as the words or substance that was actually said:

MR. RAVEL: Mr. Baxter, since you have been appointed the Assistant to the Attorney General of the Anti-Trust Division, would you tell me if there have been any changes in the Anti-Trust Laws? Would you tell me if any of the present Anti-Trust laws have been amended or deleted?

MR. BAXTER: Mr. Ravel, the Anti-Trust Laws have not been changed. They have not been amended; they are still the same way they have always been.

MR. RAVEL: In this case, if the laws are still enforceable as they have been for a great many years, why don't you enforce them? You are in charge of this Anti-Trust Division and your job is to police and enforce these old and reliable laws.

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MR. BAXTER: The big issue is that these present laws are not well written and are unfair to our society. They are not good laws and they should be either amended or eliminated.

MR. RAVEL: In fact, you are telling me here that your interpretation of these laws is different and you are using your own interpretation of these laws as an excuse for not policing and enforcing these laws.

MR. BAXTER: Yes, I do refuse to police or enforce these Anti-Trust Laws the way they are now written as I believe there have been too many abuses and these laws have been unfair to the manufacturers and distributors.

MR. RAVEL: In other words, you believe that a manufacturer has all the rights to dictate to its dealers:

How to sell the goods
To whom to sell the goods
Where to sell the goods
How to ship or not to ship
How much to pay for the goods
To accept telephone orders or not
To accept mail orders or not
To sell to other dealers for resale or not.

MR. BAXTER: Yes, I do agree that a manufacturer has all of these rights and if the dealer does not comply with the terms and conditions, the manufacturer has the right to terminate the dealer without being afraid of being prosecuted by the Government.

MR. RAVEL: Wouldn't you call these terms and conditions Restraint of trade and commerce?

(3)

MR. BAXTER: The manufacturer has the right to choose who is going to sell and distribute the goods he manufactures. He has all the rights to police and enforce the rules, terms and conditions set forth by the manufacturer and if the dealer does not comply, the manufacturer has every right to cancel him.

MR. RAVEL: Mr. Baxter, would you be kind enough to tell me "What rights does the dealer have with the manufacturer?"

MR. BAXTER: The dealer has only one right. The right to not buy from the manufacturer. No one places a gun to his head, and the manufacturer does not have the right to force the dealer to buy from him.

MR. RAVEL: That is not much of a right. It seems that we have a situation whereby the manufacter has all the rights; the dealer has no rights at all, and in the event that the independent dealer depends on this manufacturer's supplies, he has to abide to the letter or be terminated and go bankrupt.

MR. BAXTER: It is up to the dealer to obey, perform and follow the rules and regulations set forth by the manufacturer. As I said before, the dealer is not obligated and forced to buy from the manufacturer.

MR. RAVEL: What about the Robinson-Patman Act regarding price discrimination? Can a manufacturer sell the same item to a large chain let's say at 25% cheaper than

(4)

MR. RAVEL: (CONTd.) he sells to the small independent dealers, to allow the large chain to market the same item at retail prices to the consumer at below the prices the independent dealers must pay?

MR. BAXTER: Yes, I believe that the Robinson-Patman Act is not adequate and is not enforceable and should be ignored. A manufacturer has the right to sell his goods for whatever prices he chooses to sell them for to anyone he wants to sell them to.

MR. RAVEL: You stated that a manufacturer sets up rules and regulations. What would happen if you would find out that the manufacturer does not enforce these rules with all its dealers and allows some of its dealers to violate these rules with impunity?

MR. BAXTER: In this case, Mr. Ravel, I would look into this matter with a different perspective. If you could bring to me proofs that these are the facts, I would take the proper steps and I would do something about it.

That was the end of the meeting.

As soon as I returned to my offices in Los Angeles, I developed a special mailing to all Apple dealers using a ficticious name of Montsory School for Gifted Children. The response was overwhelming, showing that the Apple Computer Company was interested in terminating the mail order/discounters only. I proved my point to Mr. Baxter.

I then sent to Mr. Baxter a complete package of all the responses with an enclosed letter. His answer was flat and Mr. Baxter again refused to start an investigation of the Apple Computer Company, who

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in my opinion, are in violation of the Sherman Act, Section One, and the Robinson-Patman Act on price discrimination.

Enclosed you will find copies of letters sent by me to The Honorable William Baxter and The Honorable William French Smith.

Enclosed please find copies of some additional correspondence to and from The Honorable William Baxter, The Honorable William French Smith, The Honorable Congressman Peter Rodino and the Honorable U.S. Senator Strom Thurmond, which are self-explanatory.

It is obvious that Mr. Baxter, who has been appointed by the new administration to police and enforce the present Anti-Trust Laws, has had the audacity to make his own interpretation of these Anti-Trust Laws and completely ignores blatant violations of the Sherman Act, Section One, as well as violations of the Robinson Patman Act. Mr. Baxter is being paid by the taxpayers to perform a job which he is not performing and when a government employee or any other employee does not perform the job for which he is paid, he should be replaced by a more competent, conscientious, reliable employee who will follow the rules and patterns which have been followed for so many years.

FRANCIS RAVEL
216 S. OXFORD AVE.
LOS ANGELES, CALIFORNIA 90004
AUGUST 27, 1982.

Subscribed to and sworn to before me this 27th day of August, 1982. My Commission expires October 11, 1985.

Eleanor E. Nagy
Eleanor E. Nagy, Notary Public

ELEANOR E. NAGY
My Comm. Expires Oct. 11, 1985

STATEMENT OF FRANCIS RAVEL

To the Senate Small Business Committee and
the Senate Appropriations Subcommittee on State, Justice,
Commerce, the Judiciary and Related Agencies

Dear Senators:

I am the president and chief operating officer of the Olympic Sales Company in Los Angeles, California. I am submitting this statement for your kind consideration as part of the hearings which your Committees have held on the impact on small business of the Justice Department's current pholosophy concerning the antitrust enforcement. Thank you very much for the opportunity of letting me be heard on this important subject.

On March 4, 1982 I met with Mr. William Baxter, who is the Head of the Antitrust Division of the Department of Justice in Washington, D.C. Present at the meeting were Mr. Baxter, his Special Assistant, Ms. Melanie Stewart Cutler and Mr. Thomas Mauro, an attorney with offices in Washington, D.C., who was present on my behalf, and myself.

The purpose of the meeting was to discuss the new climate regarding antitrust matters which I, as a small and independent businessman in southern California, perceive to be developing in Washington. I believe this new climate is very detrimental to small business and travelled to Washington to inquire with Mr. Baxter about this and to discuss with him in particular my problems with the Apple Computer Company.

Our meeting began at approximately 2:00 p.m. Mr. Baxter was most generous with his time, giving me and my attorney approximately ninety minutes. Unfortunately, although I believe that we presented Mr. Baxter with persuasive evidence that recent marketing rules initiated by Apple against its independent dealers raise very srious antitrust problems, Mr. Baxter did not seem to believe that they were problems that constitute antitrust violations. My understanding of the antitrust laws differs from his, however, and this matter is especially important to me because as a result of those problems I have been terminated as an Apple dealer. Therefore, allow me to summarize for you what occurred to the best of my recollection at that meeting.

We stressed the following points with Mr. Baxter:

(1) That in terminating Olympic Sales Company, Apple was responding to pressure from its independent dealers to eliminate and dealers like Olympic Sales Company which ship products to distant customers at a discount. Thus, Apple's conduct raises plain and serious questions involving horizontal refusals to deal and price fixing under Section 1 of the Sherman Act. In support of this contention, I produced Apple's own dealer newsletter and, in particular, the published results of Apple's May 1981 survey and correspondence between Apple and Compal Computer Systems, Inc. of Beverly Hills which was directed especially to my company.

(2) That Apple's prices to Olympic Sales as compared to its prices to Computerland, for example, raise clear questions under the Robinson-Patman Act. Thus, for example, Olympic Sales did not receive the volume discounts that Apple has given to other independent dealers.

(3) That the evidence available thus far concerning Apple's termination of Olympic Sales Company suggests in addition a simple and straightforward vertical price fixing case. This was buttressed by information obtained from Apple's own marketing personnel that Apple terminated Olympic Sales Company because, and only because, Olympic sold Apple products at a discount.

(4) That Olympic Sales Company is the target and victim of a conspiracy among Apple and its dealers in a vertical sense and among Apple dealers in a horizontal sense not to deal with Olympic Sales Company. In support of this contention I refer to the statements of two other dealers, Bellino and Rubino, which I made available to Mr. Baxter.

(5) That Olympic has substantial and sophisticated national clients who purchase products mainly on the basis of price and who, moreover, have their own in-house service capability. This fact, plus the fact that Olympic Sales Company was a Level I full service Apple dealership which provides telephone service capabilities for all of its customers, was intended to demonstrate that there was no "free rider" effect present in Olympic's marketing of Apple products. Apple, using the free rider argument as a pretext, intends to use my termination to preempt for itself the national market in Apple products that Olympic had created.

Thus, the antitrust claims which Olympic Sales Company has against Apple are substantial and are by no means limited to vertical price fixing. In fact, the termination by Apple of the Olympic Sales Company presents classic horizontal problems.

Mr. Baxter seemed preoccupied with the "free rider" problem and with his own belief that a manufacturer or supplier should be allowed to do whatever it wished with its products, even though those products were sold to an independent businessman and even though my case raises serious questions that Apple has violated existing and well-settled law.

Concerning Robinson-Patman, Mr. Baxter noted that because of the Robinson-Patman Act, manufacturers and suppliers had to resort to complex marketing schemes which include the need to impose all sorts of vertical restrictions on independent dealers. Moreover, if the termination was an effort to fix a higher retail price, he asked us to explain how it was in Apple's best interest. He argued that it did not make sense for a manufacturer such as Apple to impose conditions on mail order business which would result in actual loss of sales. Therefore, he stated, he could not accept our factual contention that the termination was an attempt to fix the price of Apple products at the retail level. He said that his staff had spoken to Apple's counsel and was satisfied with their explanation that the termination was meant to eliminate the deleterious effects marketing Apple products by mail order created. Am I not entitled as an independent businessman to equal consideration by our great nation's law enforcers, especially when I present significant proof of wrongdoing by Apple? Mr. Baxter conceded that based on what I told him, my case may make out a prima facie case of price discrimination under Robinson-Patman, but he refused to become involved with the problem.

After my meeting with Mr. Baxter, I sent him proof that: (1) Apple's mail order restriction was not applied to other Apple outlets who freely sold Apple products by mail; and (2) other Apple dealers wished to see me terminated as a dealer because of my pricing policies. I developed a special mailing to all Apple dealers to purchase Apple products by mail. The response from Apple dealers was overwhelming, showing that the Apple Company new plan was a sham. I sent a complete package of all the responses with a letter to Mr. Baxter. His answer was a flat refusal to consider the matter, saying that Apple's failure to police its rules was not enough to warrant his agency's involvement.

But why does he ignore the plain evidence that the rules are a sham and simply accept Apple's unsubstantiated statements that its new marketing scheme is bona fide? (Mr. Baxter told us that he had discussed the matter with Apple prior to our meeting and was satisfied that there was nothing improper in their conduct.) The Antitrust Division has done nothing since then to investigate the matter further.

Enclosed you will find copies of correspondence between my company and the Honorable William French Smith and William Baxter and other correspondence which I believe are self-explanatory.

With all due respect I believe that Mr. Baxter is being paid by the taxpayers to perform a job which he is not performing and which is severely harmful to independent businessmen like myself. Please see to it that he will follow the rules and patterns which have been followed for so many years.

Thank you, again, for giving me this opportunity to express my views.

Sincerely yours,

Francis Ravel
216 South Oxford Avenue
Los Angeles, California 90004

September 21, 1982